

PARTNER OF CHOICE

ANNUAL REPORT 2020



Partner of choice

Annual report 2020



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Address of 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.”

Clare Spottiswoode
Supervisory Board Chair

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 achieve 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.

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.

To realize this potential, Naftogaz will need to invest USD 20-25 billion, of which about USD 7 billion shall be invested in the first 5 years (until 2025).

In order to become a strong player in the retail market, the Naftogaz Group is developing a fast-growing business in gas supply to end users and creating a user-friendly interface for our customers.

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

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 that our shareholder – the people of Ukraine – will have an efficient, financially stable, diversified company, capable to ensure the energy security of the country.

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

CEO's address



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 political influence and allows company management to act in the interests of the company and its ultimate owner, the Ukrainian people

Andriy Kobolyev
CEO

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 Ukrnafta'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 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 investor Shell. 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: Balakliiska, Ivanivska, Buzivska and Berestianska. 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 counteracting 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 minimized 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 Gordian knots we have cut, for the new projects we have launched. I am confident that whatever difficulties we may face, we are well-equipped for moving forward.

Record amount of taxes
and dividends

over UAH **140** bn

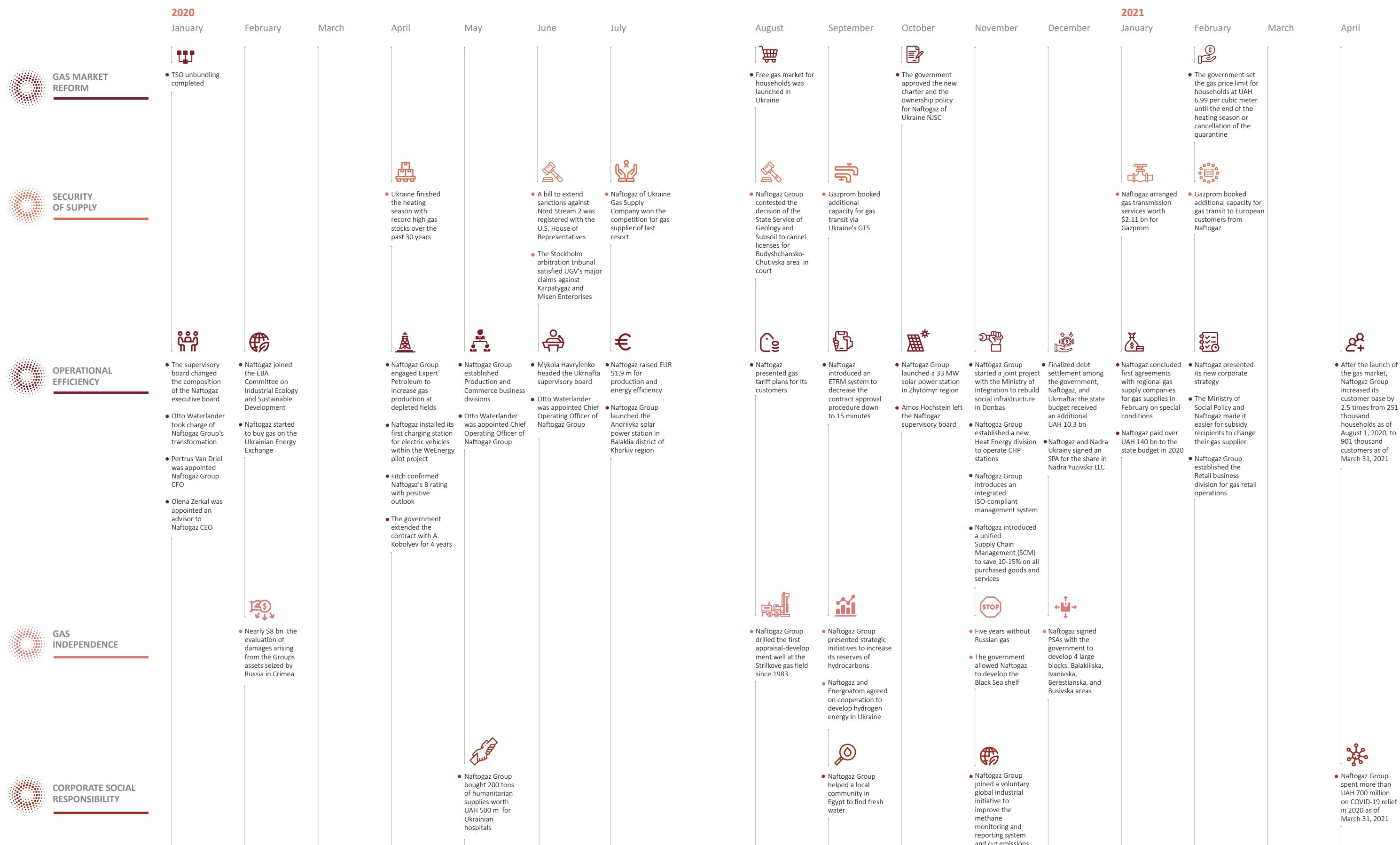
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1. MARKET AND REFORMS

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Address of First Deputy CEO

“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 value. 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 efficient. We had no other choice. Naftogaz Group employs more than 51,000 people across Ukraine and they have been retained during this difficult 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 humanitarian 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 Education and Science of Ukraine and purchased medical masks, contactless thermometers, disinfectants, insulating medical gowns, and protective shields worth UAH 15.5 million.

UAH 36 million was allocated to satisfy the current needs of healthcare providers in the regions where the Group has a business presence. These needs were mostly for personal protective equipment and consumables.

While preparing for the second wave of the outbreak, Naftogaz Group, at the request of the Ministry of Health Care, spent UAH 4.2 million to repair 49 lung ventilators.

In total, since the introduction of quarantine in Ukraine in March 2020, Naftogaz Group has allocated 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 in 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 have

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 if they get 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 start investing in new projects and developing new business areas. First and foremost, these 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 gave impetus to 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 operator made a real breakthrough in the European 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.



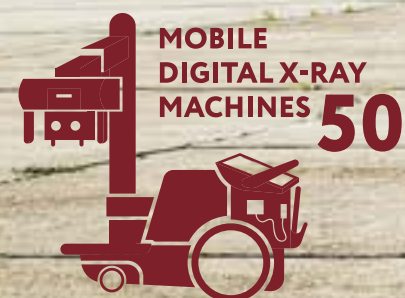
“Through our corporate social responsibility programs, we are committed to help the country overcome the pandemic and save people's lives”

Serhiy Pereloma
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 3.0%, 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 this 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 restrained 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 record low level for Ukraine of 6% per annum. In March 2021, the rate raised to 6.5% and in April – 7.5%.

Subsequently, the rate will be determined by the NBU in view of the level of inflation risks and taking into account the pace of recovery of the Ukrainian economy and changes in social standards for the population.

A significant drop in imports of goods and services by 12.5% in 2020 (mainly due to a decrease in imports of energy products) against a slight decrease in exports by 7.8% (due to ferrous and nonferrous metals and agricultural products) had a positive impact on the balance of payments.

Significant government debt payments were partially offset by a new external IMF tranche (USD 2.1 billion) received in June 2020 under the new 18-month standby program. This tranche helped Ukraine cope with the initial effects of the quarantine. However, in February 2021, the IMF refused to provide a second tranche, in part due to the return of a temporary gas price regulation.

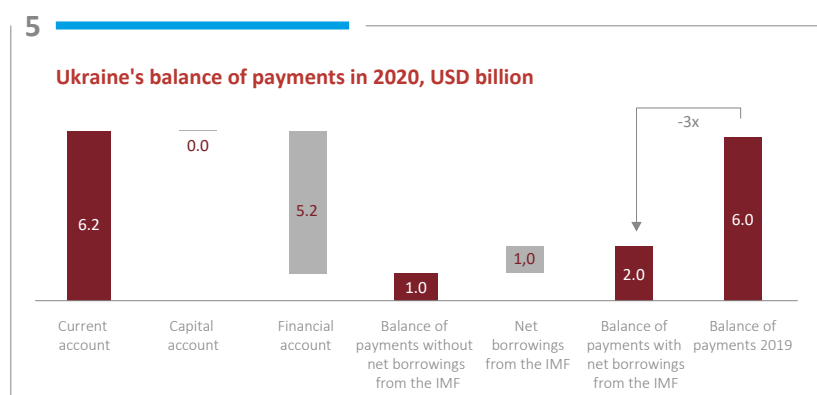
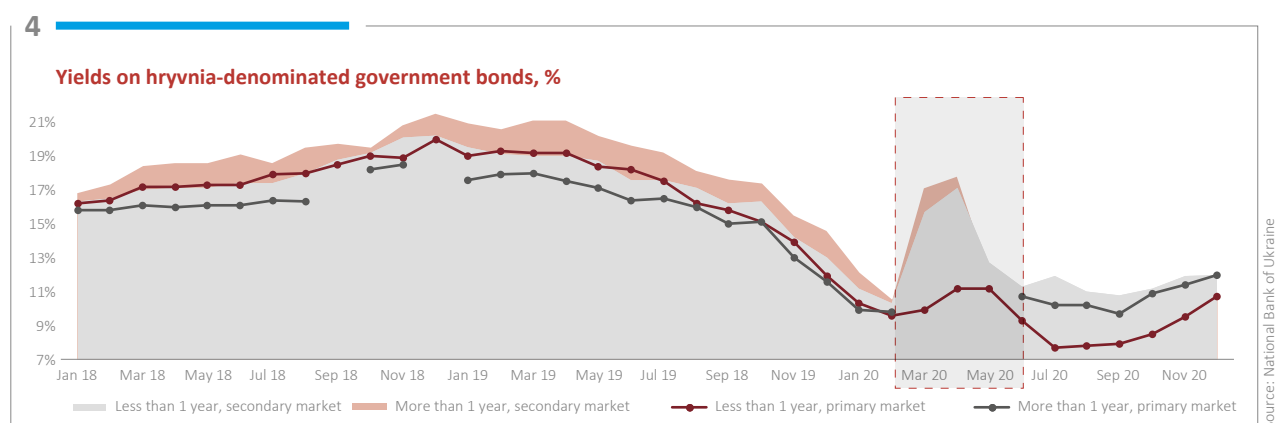
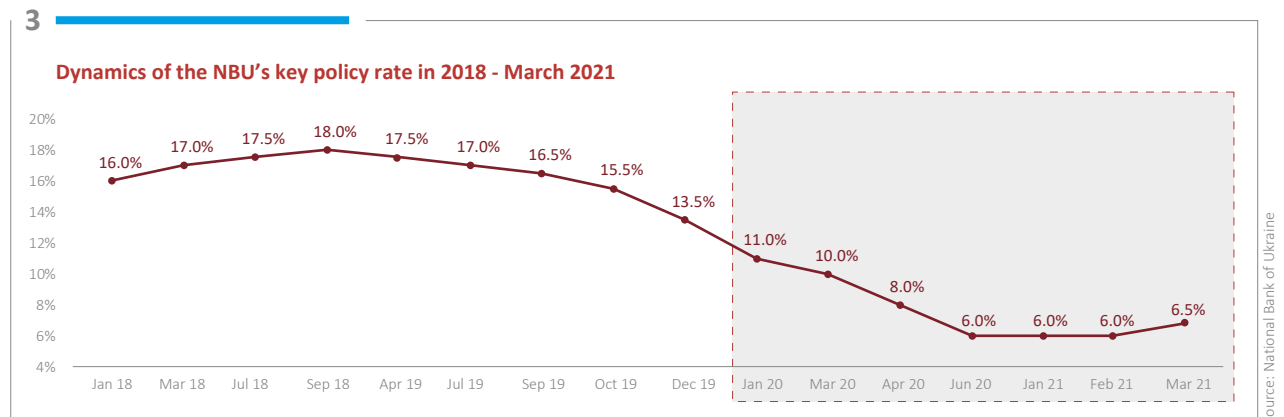
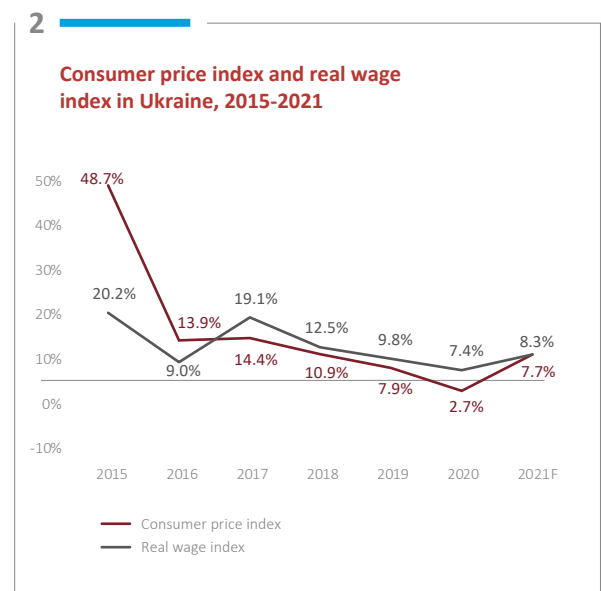
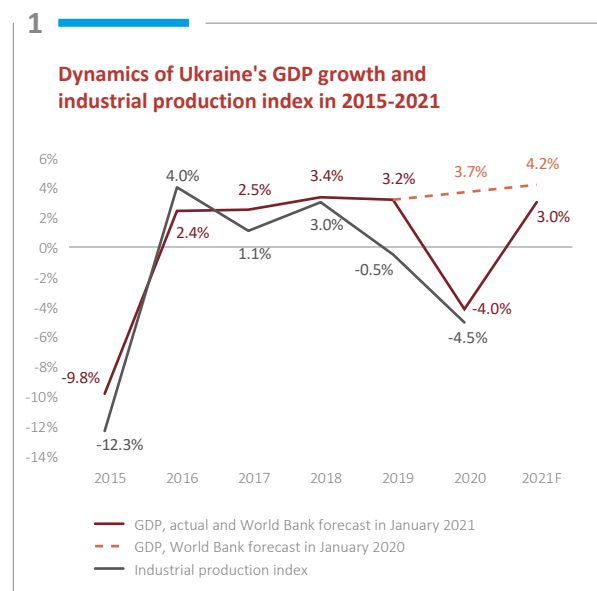
According to the NBU forecasts, in 2021-2023, Ukraine will experience a current account deficit, which will be caused by the growth of external demand, the resumption of investment activity, and a decrease in gas transit.

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 whetted 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 yield 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 debt securities by the Ukrainian government.

At the end of 2020, the Ukrainian government issued government Eurobonds – 7.253% 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



Ukraine's GDP decrease

-4.4 %

compared to 2019, according to the State Statistics Service

Projected GDP growth in 2021

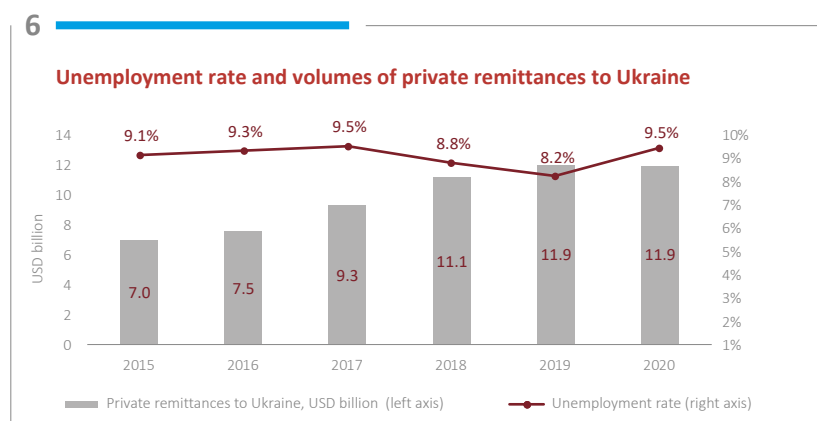
+3.0 %

Ukraine is expected to overcome the negative effects of the pandemic in 2021 and return to pre-crisis GDP growth rates

Gross international reserves

UAH 29.1 billion

A 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



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 29.1 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.

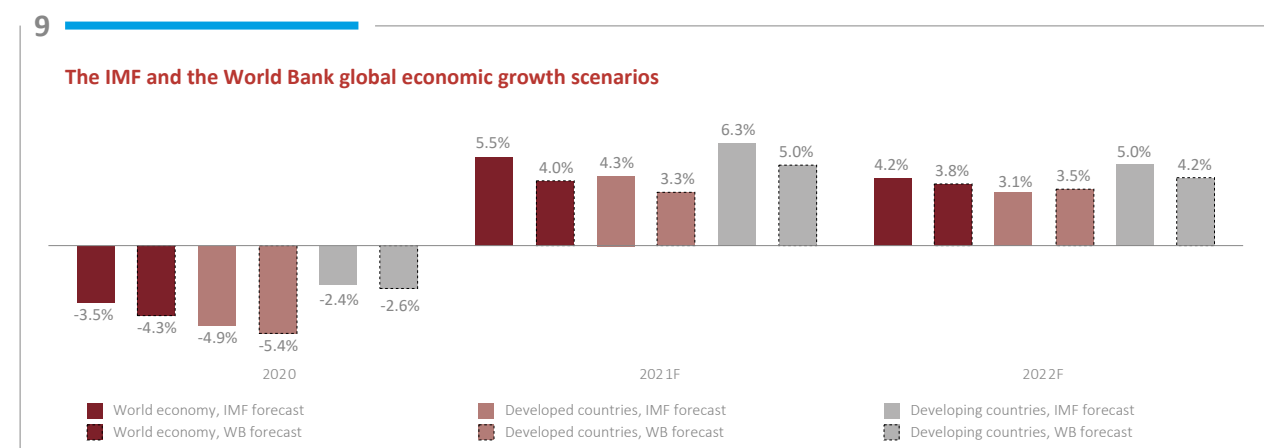
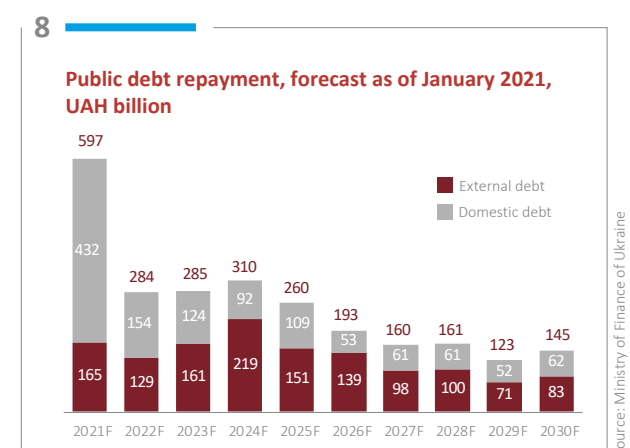
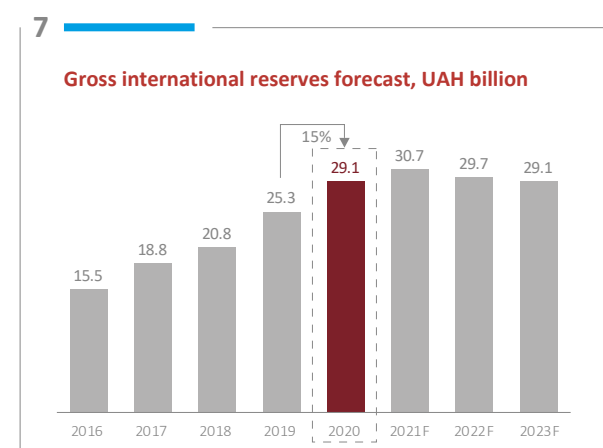
Ukraine is forecast to overcome the negative effects of the pandemic in 2021 and return to pre-crisis GDP growth rates: + 3% and + 4.2% according to the World Bank and the NBU, respectively. Growth will be driven by external demand as a result of an increase in real incomes and pickup in the investment 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 revival 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 economic decline in 2020 at 3.5% and 4.3%, respectively, while 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 roared back to pre-coronavirus growth rates, has supported increases in energy and commodity prices.

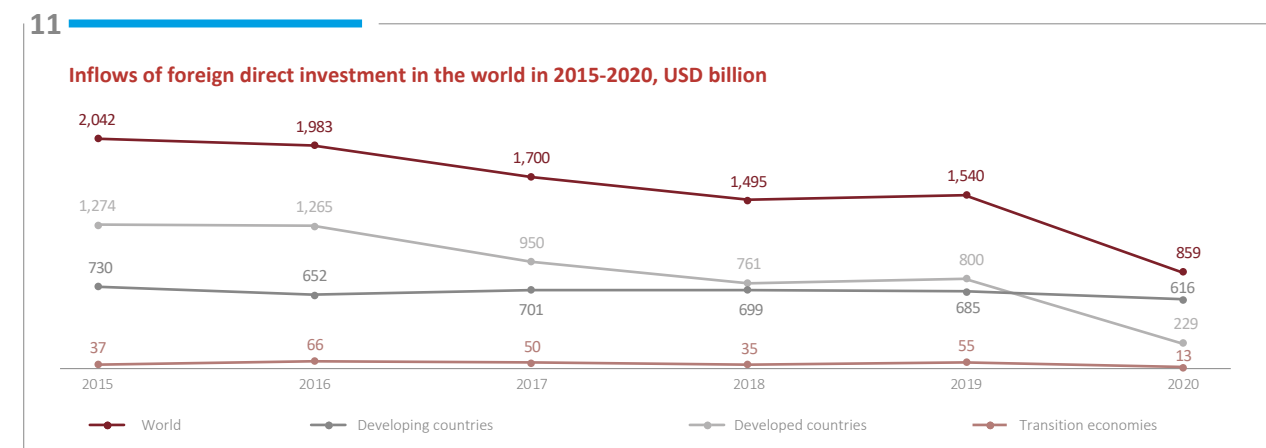
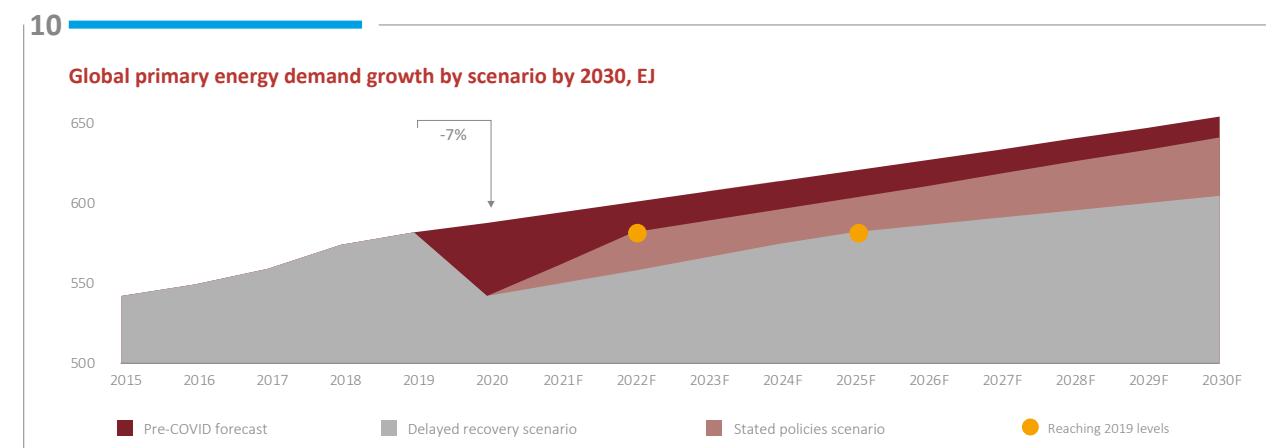
- According to a McKinsey study, energy demand fell by 7% in 2020 due to declining economic activity. The International Energy Agency (IEA) expects that under the baseline development scenario, energy demand will return to pre-pandemic levels in 2022.

Uncertainty over the duration of the pandemic and tight quarantine measures have 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 42% 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 unpredictable 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 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. German IPI partially recovered to -13.5, 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 Q4 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. **1**

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. **2**

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. **3**

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

TTF gas prices change y-o-y¹

-30 %

Global gas consumption²

-2.5 %

Global gas production³

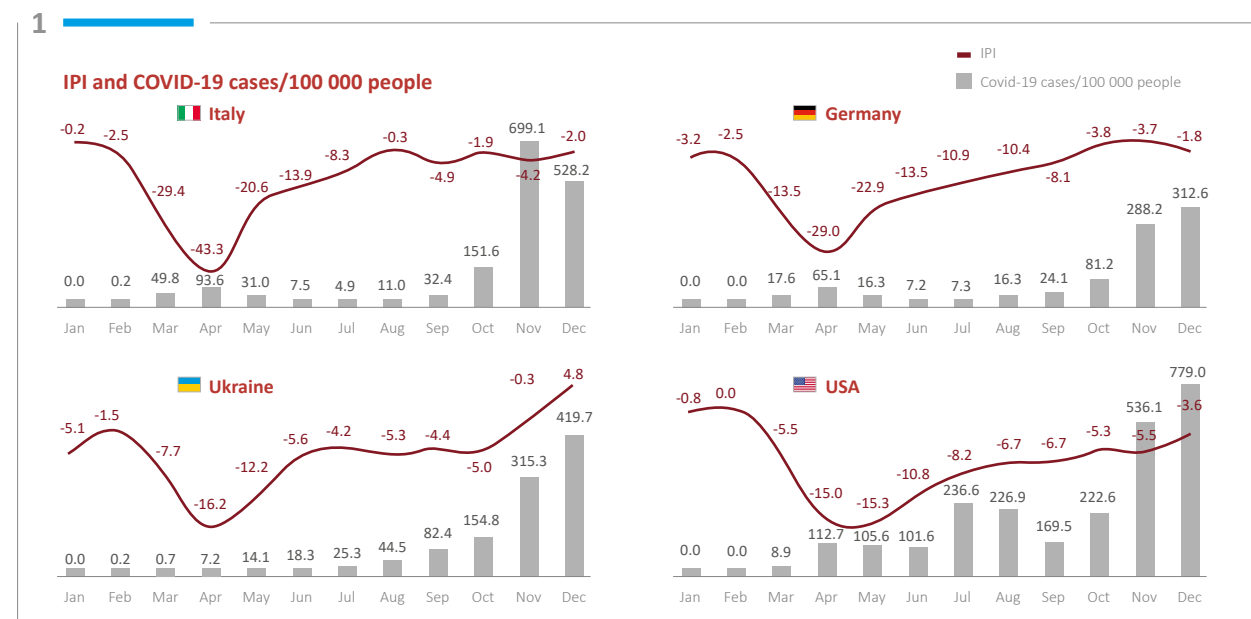
-3.6 %

¹ Based on Bloomberg data and in-house calculations

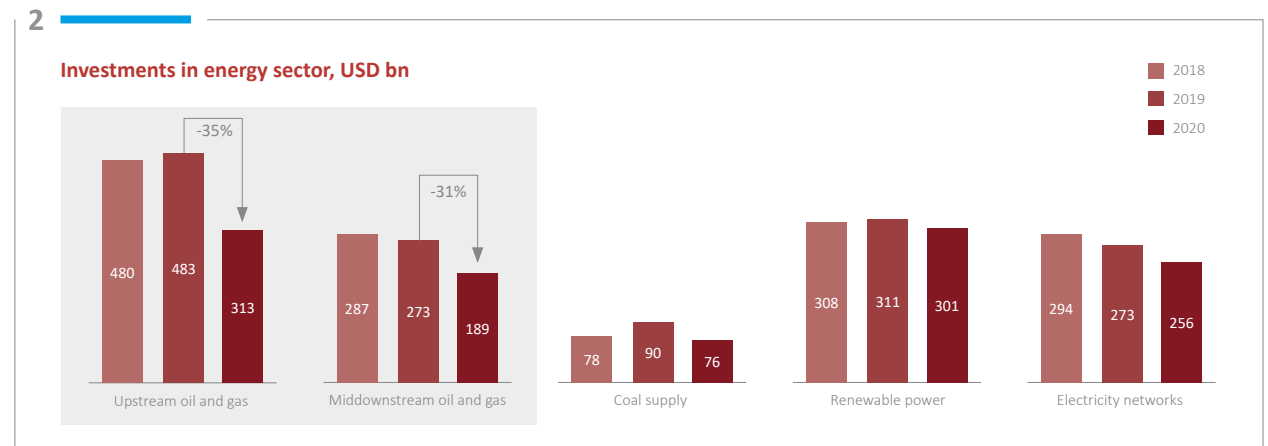
² <https://www.iea.org/reports/gas-market-report-q1-2021>

³ <https://www.oil.com/general-interest/economics-markets/article/14190111>

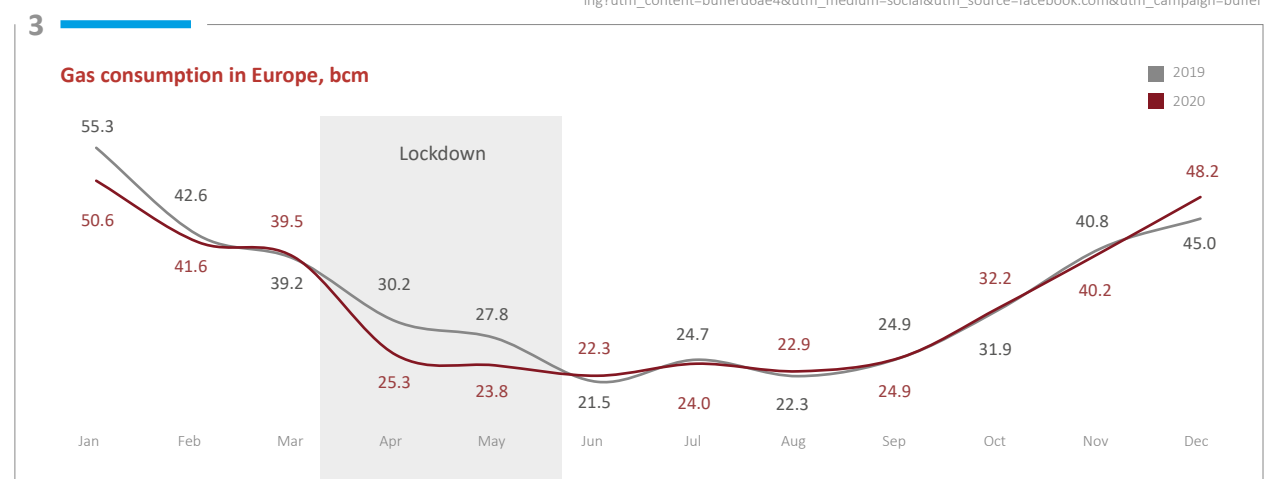
⁴ https://www.iea.org/articles/investment-estimates-for-2020-continue-to-point-to-a-record-slump-in-spending?utm_content=bufferd6ae4&utm_medium=social&utm_source=facebook.com&utm_campaign=buffer



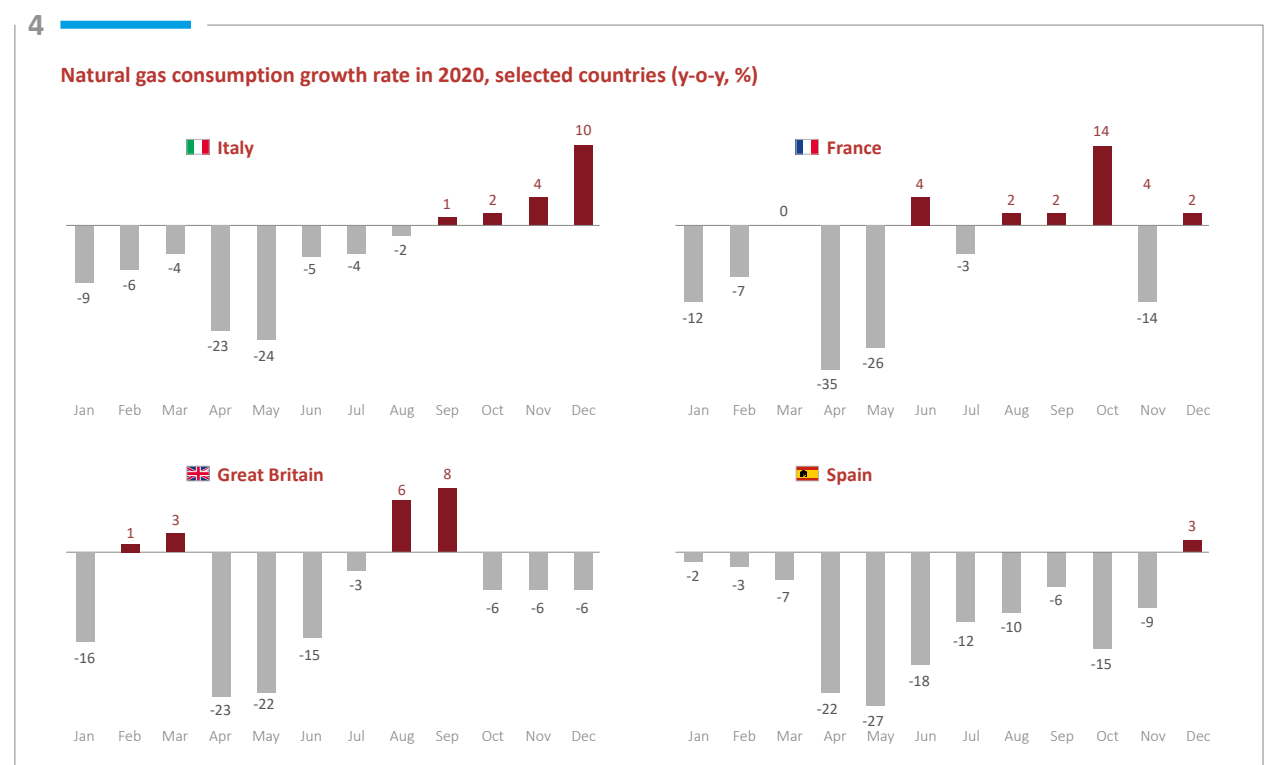
Source: https://www.iea.org/articles/investment-estimates-for-2020-continue-to-point-to-a-record-slump-in-spending?utm_content=bufferd6ae4&utm_medium=social&utm_source=facebook.com&utm_campaign=buffer



Source: https://www.iea.org/articles/investment-estimates-for-2020-continue-to-point-to-a-record-slump-in-spending?utm_content=bufferd6ae4&utm_medium=social&utm_source=facebook.com&utm_campaign=buffer



Source: Eurostat

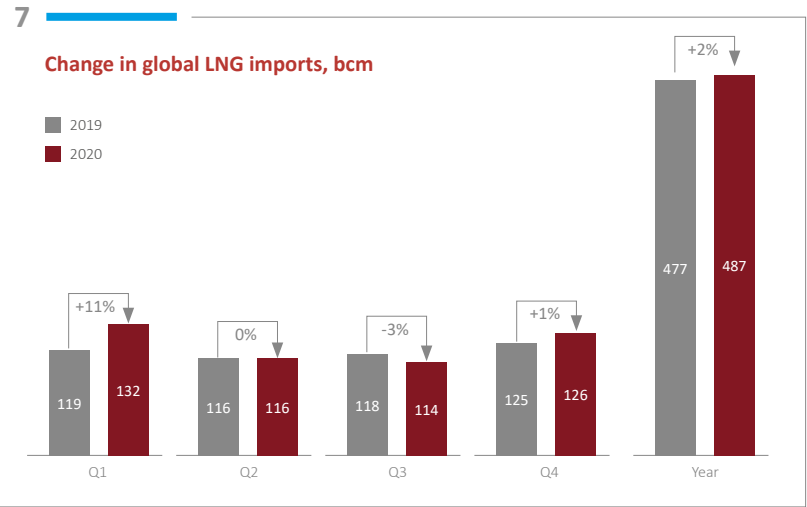
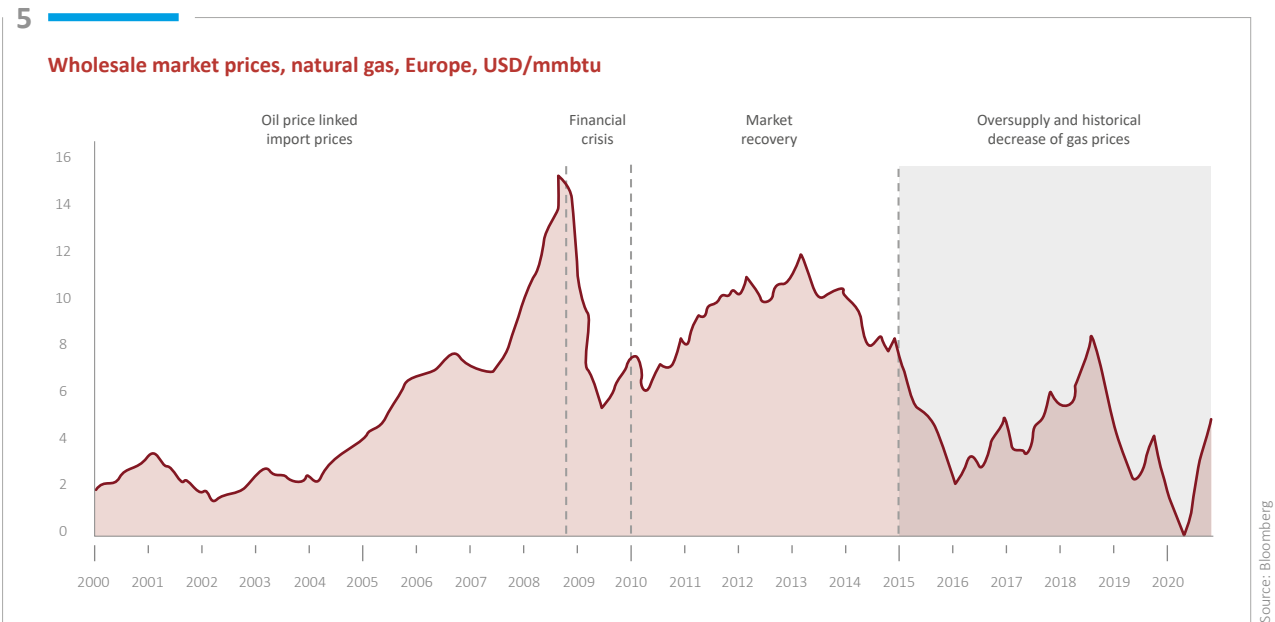
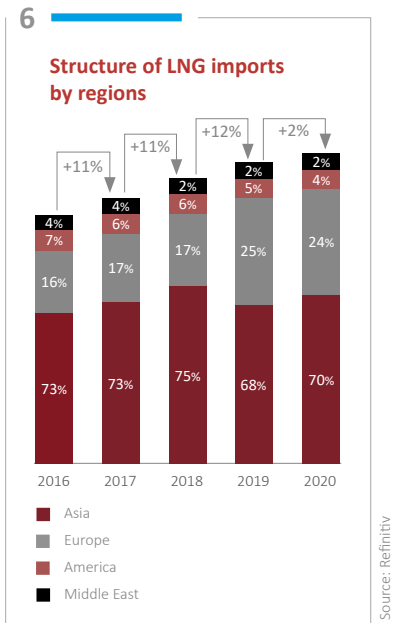


Source: own calculations based on Eurostat data

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 -23% and -35% y-o-y. **4**

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 59% less than in January 2020, or 66% less than 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). **5**

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 temperatures throughout Europe, have significantly affected price increases on the main EU hubs. In January 2021, spot prices on European hubs were 4 Euro/MWh (or by 26%) higher than in December 2020, reaching the level of February 2018. In addition, the increased demand also affected the withdrawal rate for gas storage, which was twice as rapid compared to the previous year. This further supports high gas prices and is expected to deter seasonal summer decline.



Global LNG demand growth in 2020

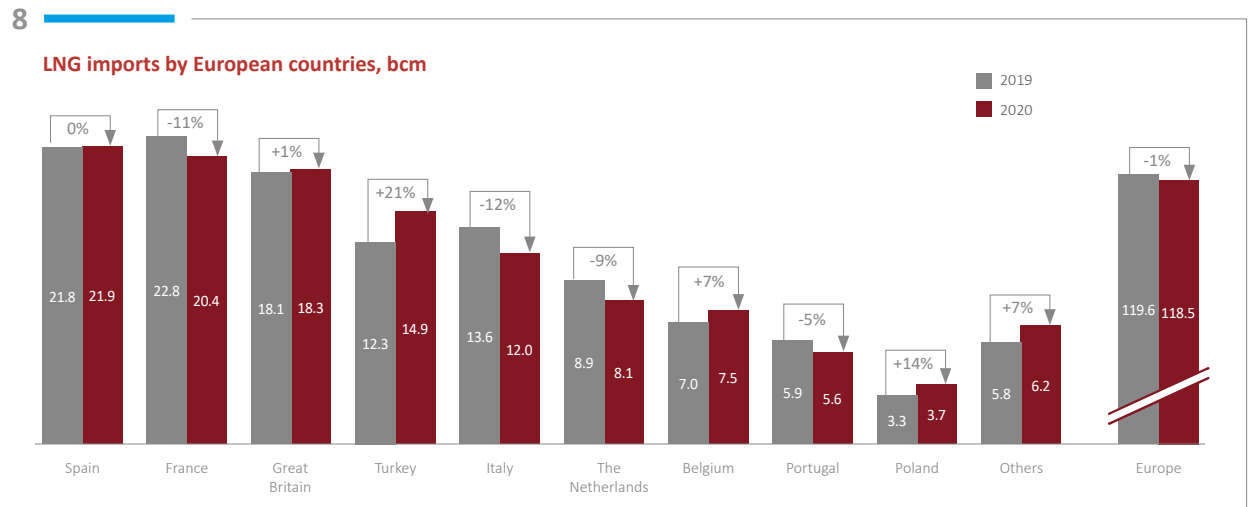
+2 %

European LNG import growth in 2020

-1 %

Lower global LNG growth rate in 2020 compared to 2019

5 times



GLOBAL LNG MARKET

Global LNG demand increased by 2% in 2020 to 360 million tons, despite the COVID-19 pandemic, with further 3% growth forecast in 2021. Compared to 2019, when the global LNG market grew by 12%, the growth rate is much lower and is driven mainly by the rapid growth in Asian demand, particularly in China.

2020 showed that the global liquefied natural gas market is flexible. In the context of declining GDP, even in developed countries, LNG trade continues to grow, although not as fast as before. According to Shell, growth in LNG supply capacity was mostly limited to the USA, where 21 million tons of new liquefaction capacities started commercial operations in 2020. Liquefaction plants already in operation in the USA responded to the weak gas price environment by significantly curtailing production in the middle of the year. Supply from LNG-exporting countries such as Egypt, Malaysia, and Norway was also lower (by 62%, 12%, and 6% respectively) year-on-year because of operational disruptions and shut-ins to prevent economic losses.⁴ **6**

China and India were first from the top list of the countries to restore demand for LNG since the pandemic outbreak, increasing LNG imports by 11%. China's long-term goal of becoming carbon-neutral by 2060 will only increase demand for LNG in the region in the coming years. India has also increased gas imports, taking advantage of low energy prices in Q2-3, 2020, and supplemented domestic gas production by these volumes.

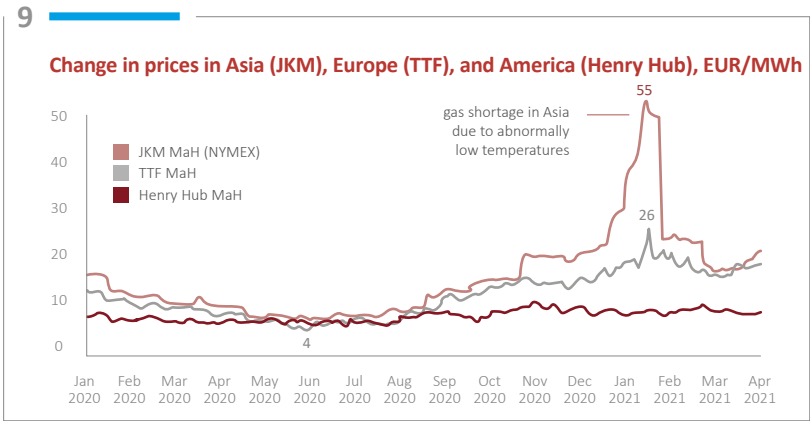
Global demand for LNG is expected to reach 700 million tons by 2040, almost doubling from 2020 levels. As demand for natural gas continues to grow rapidly in Asia, it is expected to drive nearly 75% of this growth as domestic gas production declines and

LNG substitutes higher emission energy sources, tackling air quality concerns and meeting emission targets. **7**

LNG demand in Europe declined slightly in 2020 (0.9% year-on-year). The main reason for the decrease in the growth rate of LNG imports was the oversupply of gas on the European market in 2020. In total, 118.5 bcm was imported, which is about 25% of total natural gas consumption in Europe. **8**

Long-term contracted LNG prices in the Asia-Pacific region in 2020 were lower than in 2019 because they are predominantly indexed to oil prices, particularly the Japan Customs-cleared Crude (JCC) index which dropped by 32% year-on-year, tracking Brent

⁴ <https://reports.shell.com/annual-report/2020/servicepages/downloads/files/shell-annual-report-2020.pdf>
⁵ <https://www.shell.com/energy-and-innovation/natural-gas/liquefied-natural-gas-lng/lng-outlook-2021.html>

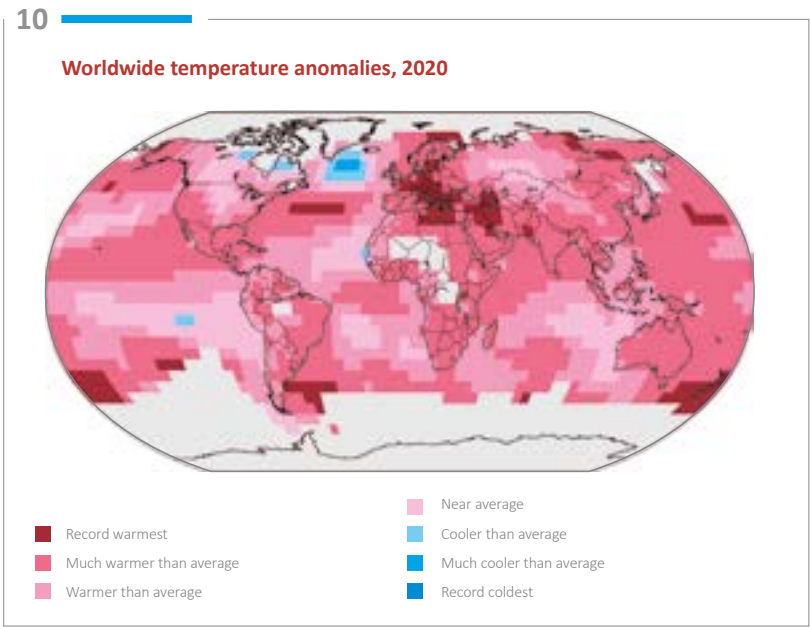


crude prices. Meanwhile, delivered North Asia spot prices, reflected by the Japan Korea Marker, declined by 20% compared with 2019, because of oversupply in the global LNG market and weak demand. Looking ahead, we expect gas markets in North America, Europe, and Asia-Pacific to find support from markets recovering from the pandemic. Price developments are very uncertain and dependent on many factors. **9**

It is worth noting that market volatility levels are likely to increase in the future, as the number of long-term contracts in the structure of gas consumption in Europe decreases with a simultaneous increase in short-term contracts. The gas market is being transformed from forward to spot, as oil-indexed contracts are becoming less popular. This trend will increase the influence of seasonal factors on price and create a basis for unforeseen price fluctuations in the natural gas market. In such conditions, the role of LNG in balancing short-term fluctuations will grow.

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 2005. 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. **10**

Europe had its warmest year over the observation period with 2.16°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 1910; 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

2nd

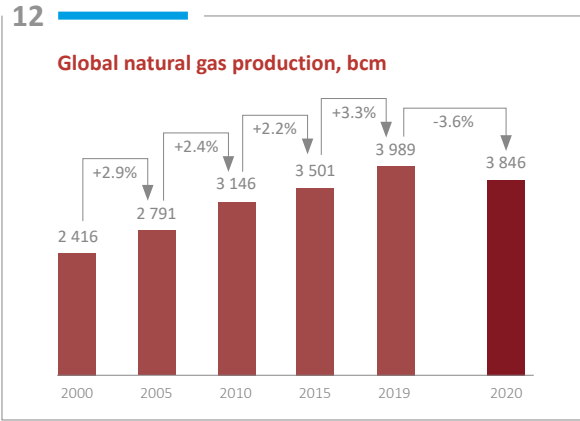
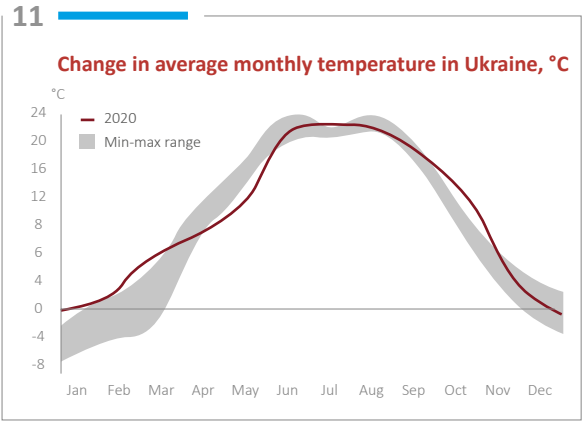
Warmest year globally

1st

Warmest year in Europe

11.1°C

Average annual temperature in Ukraine (the warmest year ever)



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 volatility observed during last year creates the conditions for natural gas price volatility, along with a deterioration in gas market forecast quality. **11**

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 (+32%) 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.⁵ 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. **12**

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 decline 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 6th country by production volume in Europe (5.6 bcm in 2020). **13**

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 Ukrasvydobuvannya, 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, Ukrasvydobuvannya 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 price by 30%, and reduction of investments by 50%, the company minimized the rate of production decline. Ukrasvydobuvannya produced 1.13 bcm of natural gas

⁵ <https://www.rystadenergy.com/news-events/news/press-releases/gas-year-2020-review-global-gas-production-exceeded-demand-us-led-liquefaction-capacity-race/>



-3.6%

Global gas production

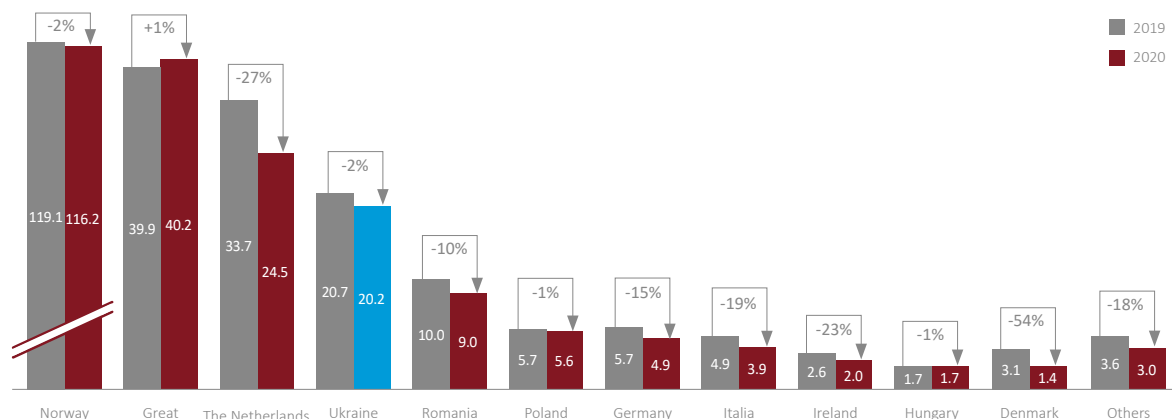
-13.2%

European gas production

-2.4%

Ukraine's gas production

13

Change in European natural gas production in 2019-2020, bcm


Source: Eurostat

in 2020, which is 3.0% (or 33 mcm) less than in 2019. On the other hand, private gas producers continued to increase gas output, reaching the level of 4.86 bcm in 2020, which is 5% higher than in 2019, thereby strengthening their position in the Ukrainian gas market. **14**

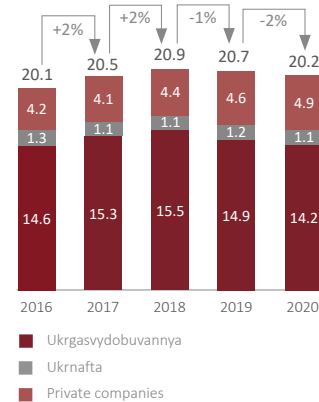
In 2020, there were seven private gas production companies that produced more than 0.1 bcm of gas. Four of them – Zahidnadrasservice, Naftogazvydobuvannya, Smart Energy, and Burisma – increased gas production in 2020 compared to 2019. The rest – Ukrnaftoburinnya, Geo-Alliance, and PPC/JKX – decreased production in 2020. Naftogazvydobuvannya (DTEK 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 3.3% lower than in 2019. As a result, net imports of natural gas decreased by 33 bcm (-8%) 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). **15**

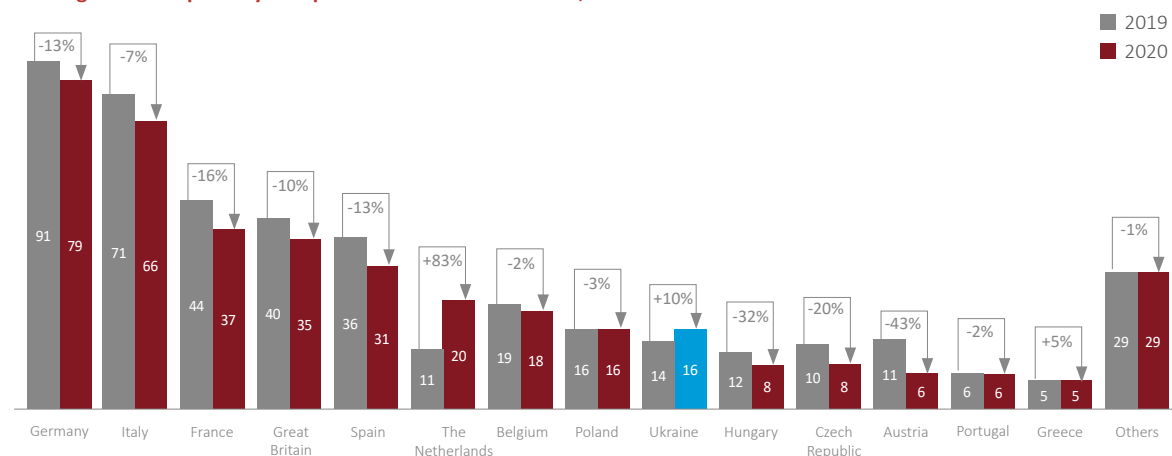
Ukraine is one of the few countries in Europe that increased gas imports in 2020 compared to 2019. In total, 15.8 bcm was imported during the year (+1.6 bcm compared

14

Natural gas production structure in Ukraine during 2016-2020, bcm


Source: ExPro, UGV, UkrNafta

15

Change in net imports by European countries in 2019-2020, bcm


Source: Eurostat

to 2019). Because of low natural gas prices, local and European traders used significant volumes of Ukrainian UGS facilities (which are the largest in Europe) to inject gas at low prices with subsequent exports/sales during the winter season.

Since the beginning of 2020, gas import flows have been represented by physical imports and virtual reverse flows. 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 Drozdovichi 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 Kapushany – Uzhhorod) and Hungary (through the single virtual interconnection point “Bereg” (a merger of IP Beregovo 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. **16**

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 65%, 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 further export 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 transit per year, and the first phase of TurkStream 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. **17**

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 mcm 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 (-70%): 3.0 bcm to Moldova and 0.9 bcm to Romania.

EU gas import

-8 %

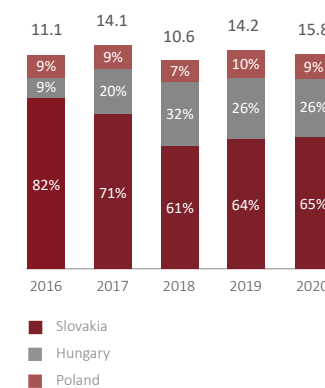
Ukraine's gas import

+10 %

Naftogaz share in total import

7 %

16

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


Source: TSO of Ukraine

Total gas transit through Ukraine

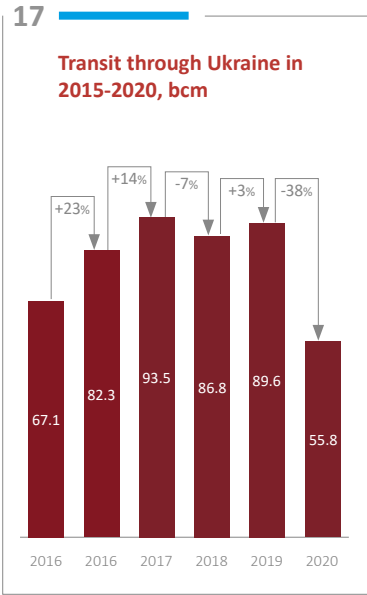
-38 %

Total gas transit volume through Ukraine

55.8 bcm

of total Russian transit to Europe was through Ukraine

32 %



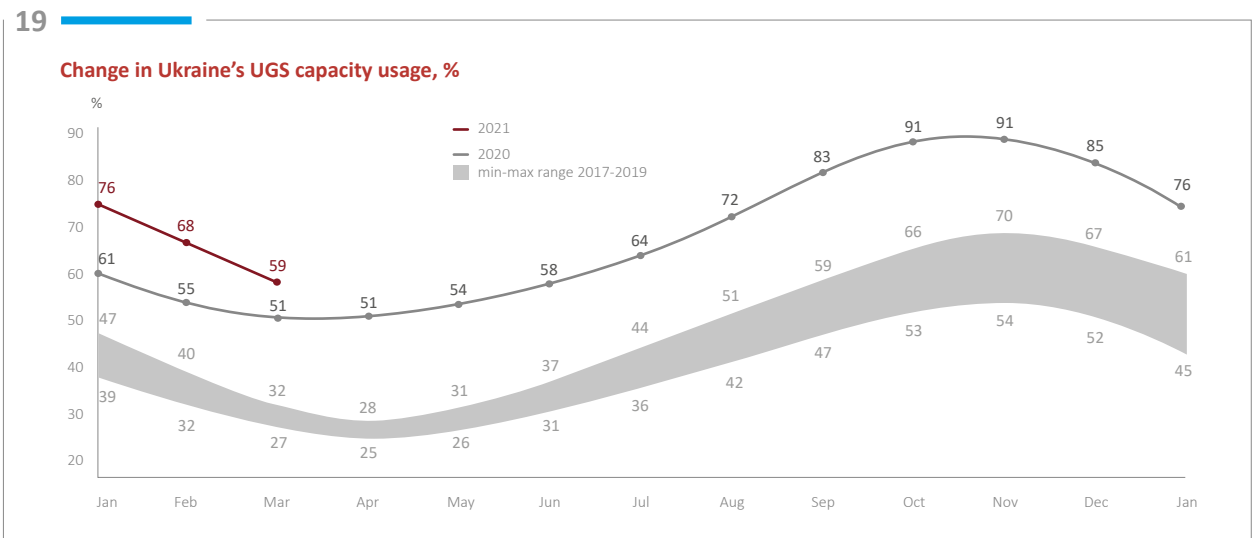
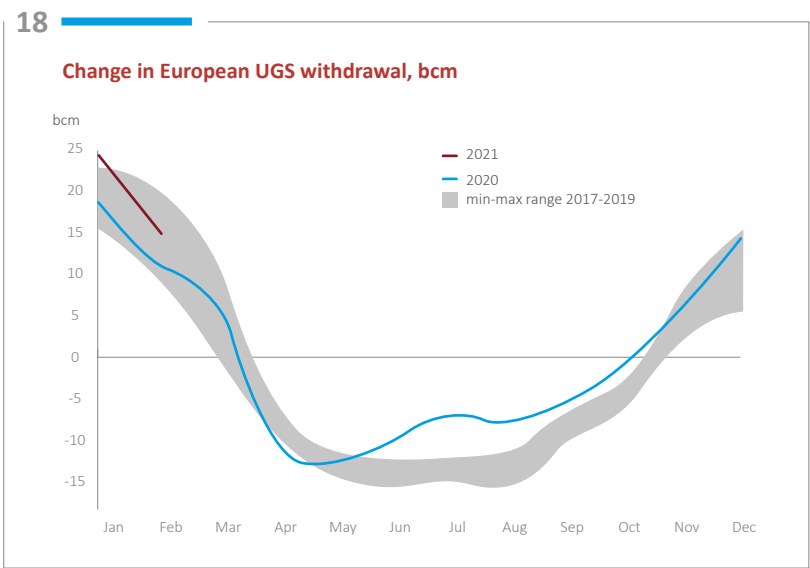
RECORD UNDERGROUND GAS STORAGE WITHDRAWALS

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. **18**

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). **19**

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. **20**

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. **21**

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. **22 23**

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 (+82%) 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. **24**

Total UGS capacity in Ukraine*

31 bcm

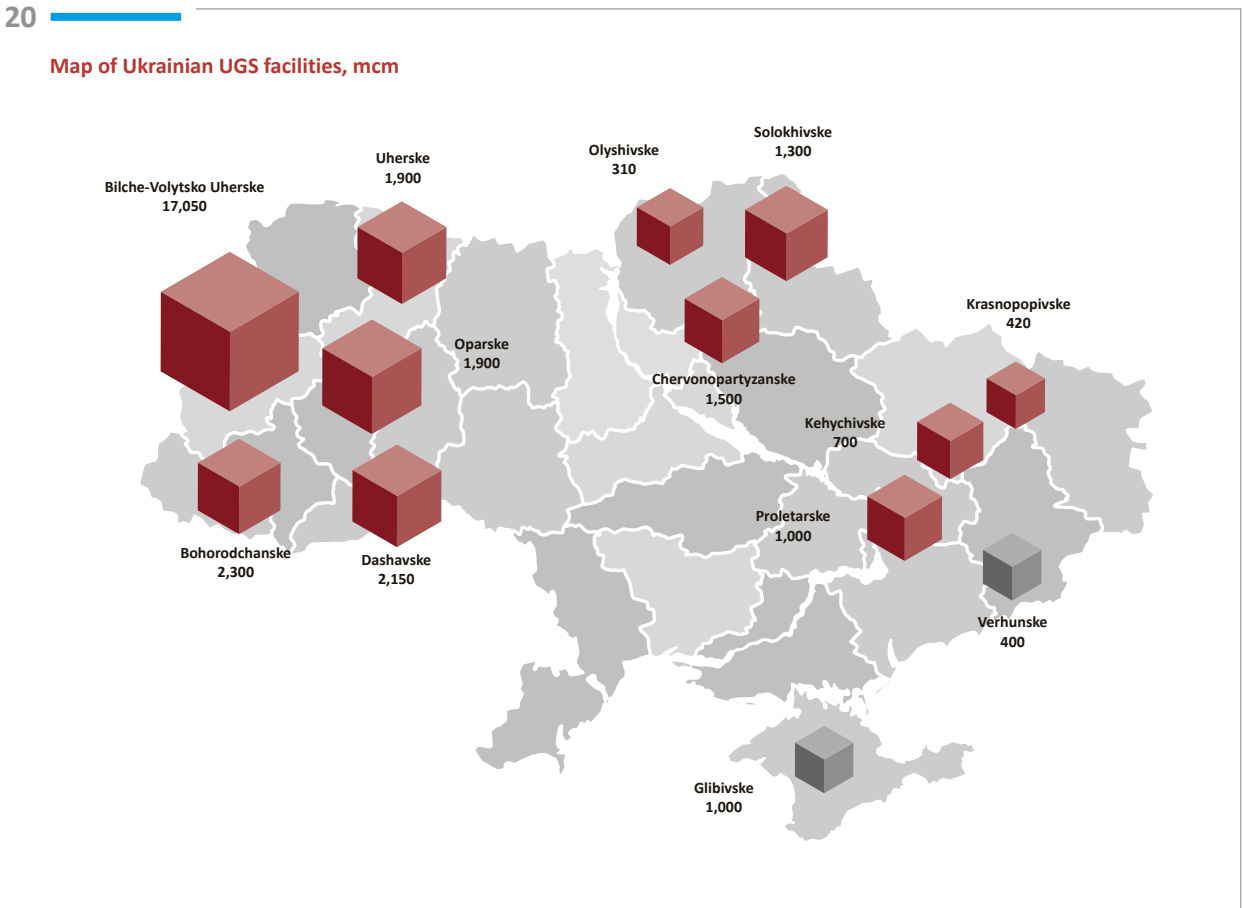
Natural gas volume in European UGS decrease

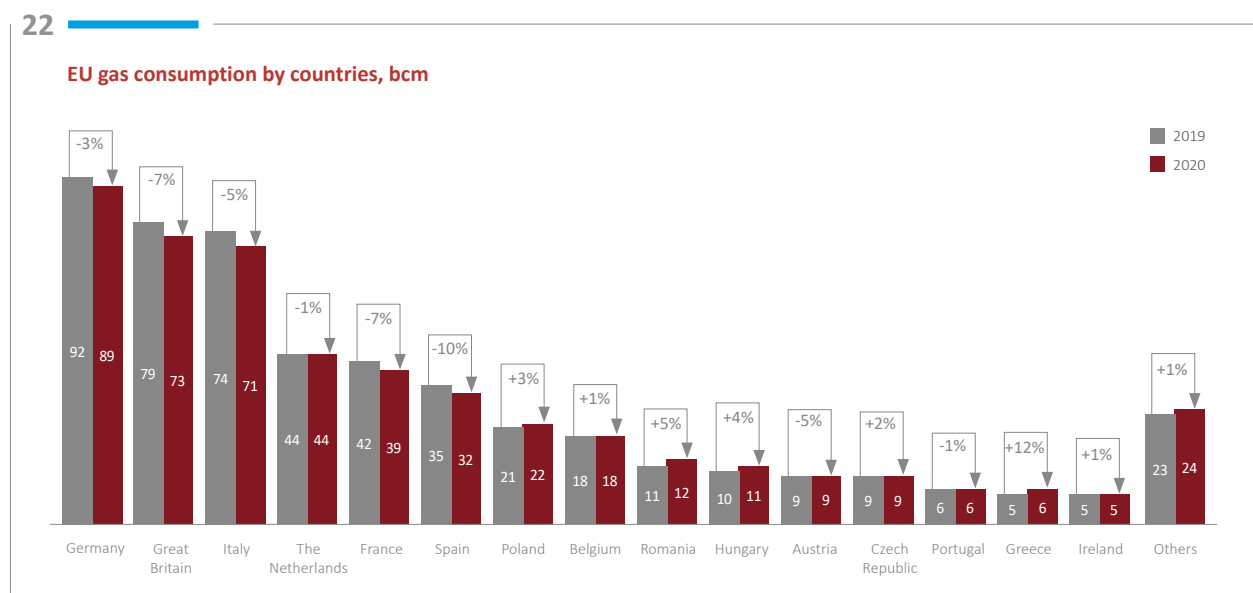
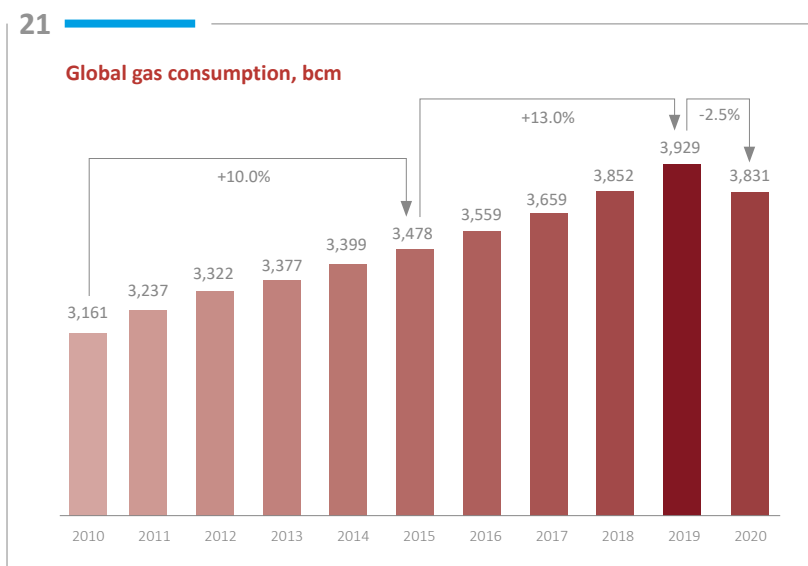
-14.1 bcm

Natural gas volume in Ukraine's UGS increase

+4.8 bcm

* excl. Glibivske UGS, which is located in the Autonomous Republic of Crimea





UKRAINIAN GAS MARKET

KEY RESULTS OF THE WHOLESALE GAS MARKET:

- 2020 was very successful in terms of gas sales on the Ukrainian Energy Exchange (UEEX). Total sales of natural gas increased to 2.5 bcm, which is 6.5 times more than in 2019;
- Development and the introduction of a new short-term market (day-ahead and intraday markets) on the UEEX made it possible to improve the liquidity of the market participants' portfolio;
- Implementation of new instruments (paying options) on the UEEX, such as sales of natural gas with post-payment terms using a bank guarantee, extended post-payment period from 30 to 45 days; and introduction of quarterly products (fixed price for the supply during Q4 2020/Q1 2021);
- Establishment of market approach for setting PSO prices based on market (TSO) spreads;
- According to the Gas Hubs Benchmarking Study provided by the European Federation of Energy Traders (EFET), Ukraine made the greatest gains in 2020, achieving a score of 9 points out of 20, which is a clear evidence of transparent market development. In recent years, the wholesale gas market has been progressively developing.

Global gas demand

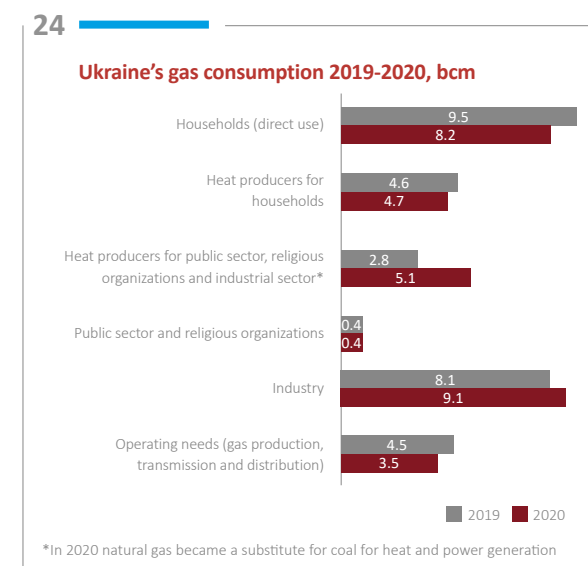
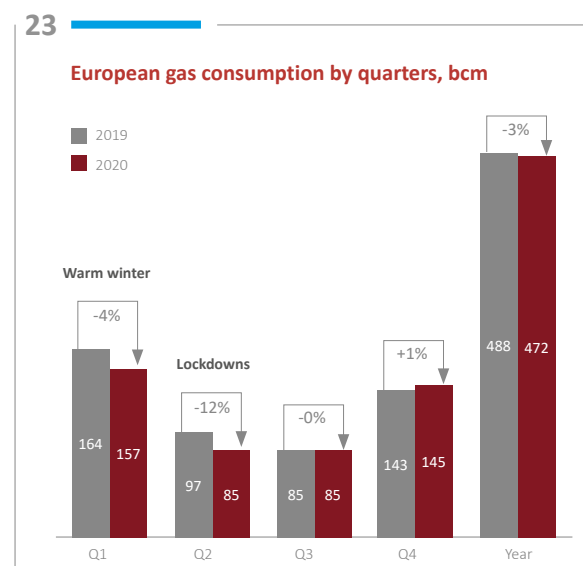
-2.5 %

European gas demand

-3.3 %

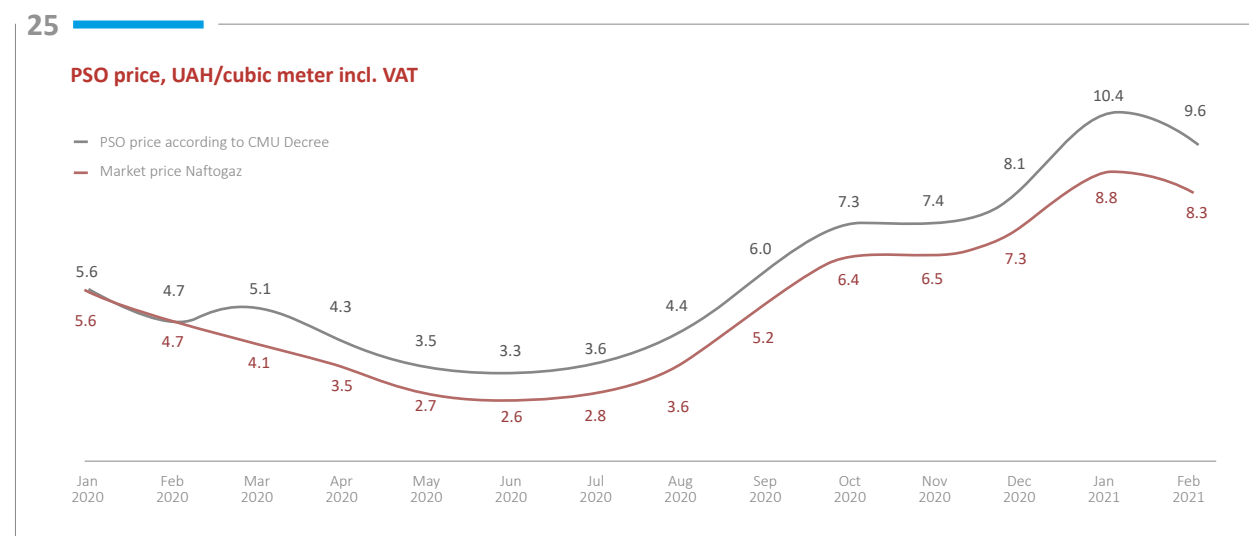
Ukraine's gas consumption growth

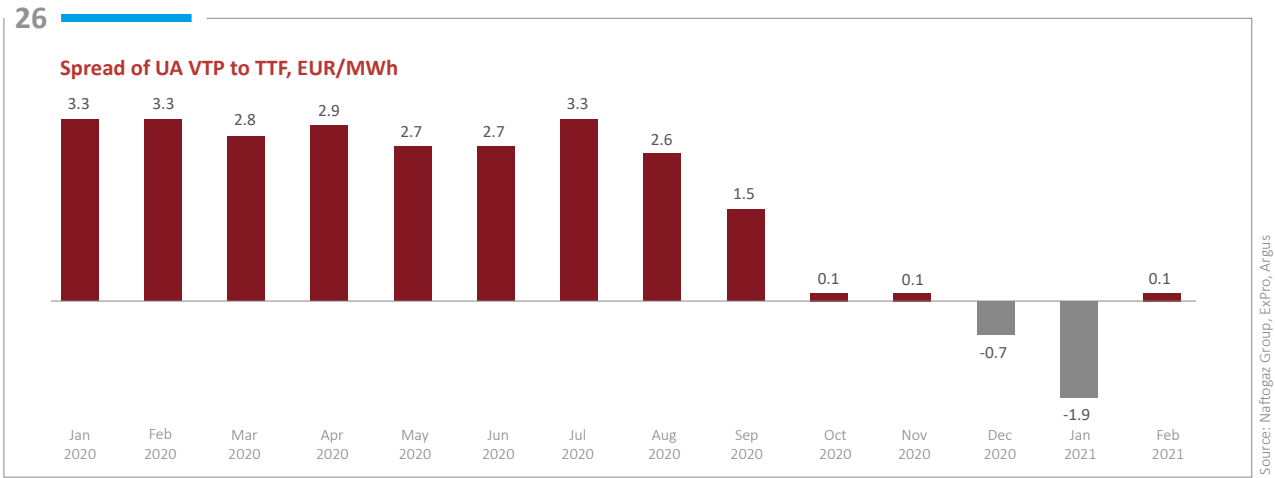
3.7 %



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 deliveries 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 10.1 bcm of imported volumes was injected to UGS facilities in the “customs warehouse” mode. Moreover, 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.



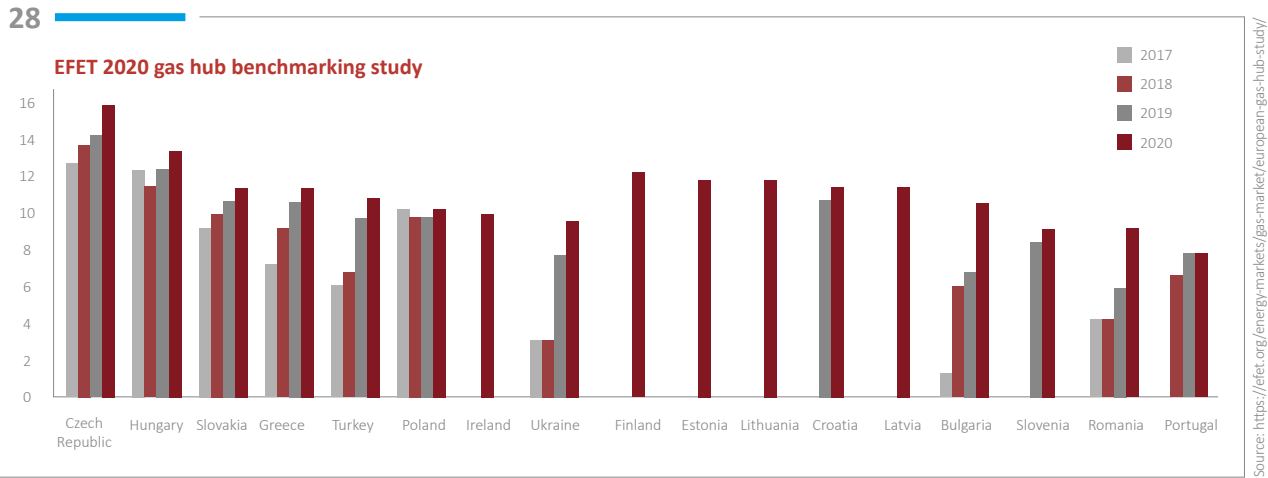
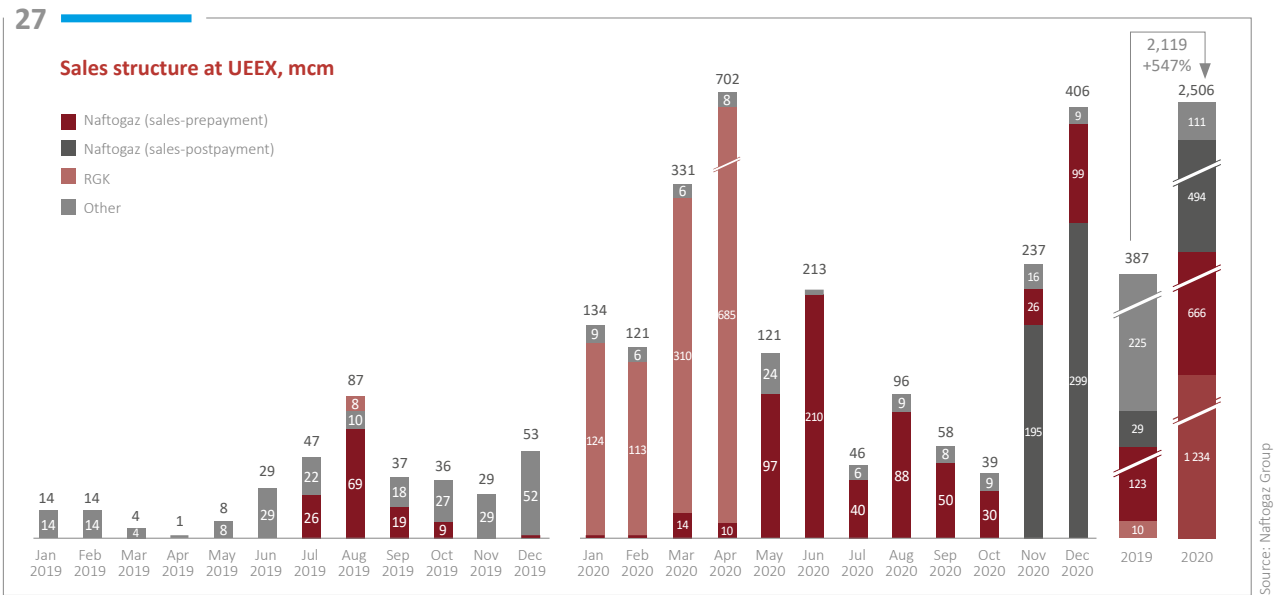


Moreover, in 2020, Naftogaz completely transferred to market pricing, even in supply to the regulated segments (PSO customers). It should be noted that the foundations for the liberalization of gas prices for PSO were laid gradually in 2019, including coupling with market indicators. At the beginning 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. **25**

Supporting the market-based gas pricing mechanism, the company shifted from the pricing methodology recommended by the CMU resolution to market-based pricing. Therefore, 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 TSO 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 price-setting for PSO consumers. Thereafter, a newly adopted PSO pricing methodology was

based on the market benchmark — the weighted average prices that were set on the Ukrainian Energy Exchange for a specific supply month. **26**

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 RSCs 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. **27**

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 17.5-19.5 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 county's gas market was just opening, with a score of 2. **28**

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, Megawatt, OKKO, etc.;
- More than 600,000 customers have changed their gas supplier since the liberalization of the retail gas market.

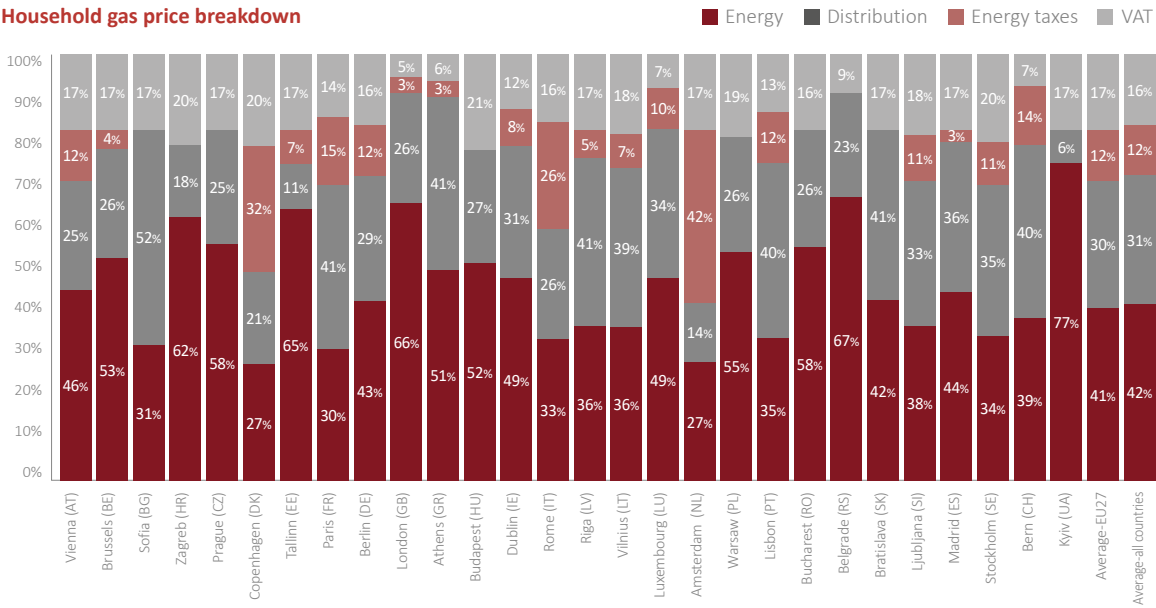
In 2020, Ukraine introduced a retail gas market for households. Starting from 1 August 2020, gas prices for direct household clients were set according to market levels, while the process of changing gas supplier became much easier and more transparent. The procedure to change gas supplier before the cancellation of PSO regime could take up to 100 days, but starting from 1 July, clients were able to change their gas supply company within 4-15 days. Moreover, some suppliers, in particular Naftogaz of Ukraine Gas Supply Company, have launched a service that allows clients to change their supplier without leaving home by using an electronic signature or Bank ID system. Any person can conclude a gas supply agreement with a preferred gas supply company, regardless of its place of registration.

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 retail gas market in Poland is estimated at 14.5 million households and ranks seventh in Europe in terms of number of households. **29**

Liberalization of the retail gas market showed considerable flexibility of households, and as a result more than 600 thousand clients have switched their gas supplier during the first five months on 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 started heavily compete 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 transportation costs. According to the household price index report retail gas sales prices in the EU were on average by 286% higher than the gas sales prices in Ukraine. That is mainly explained by the high transportation costs and energy taxes. **30**

Household gas price breakdown

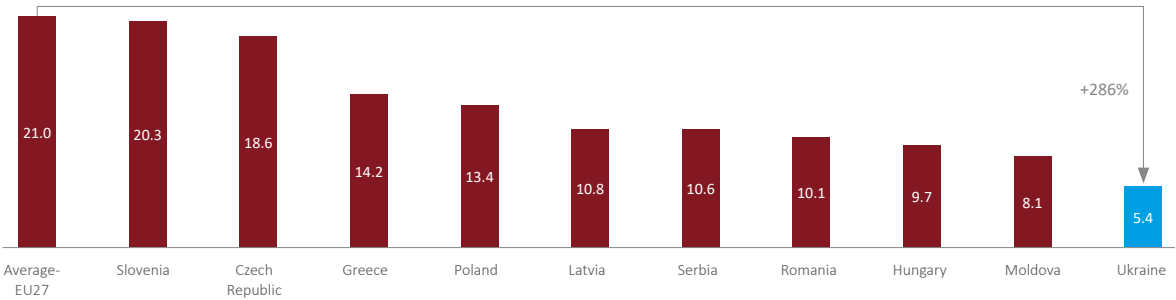


Source: <https://www.energypriceindex.com/latest-update>

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.

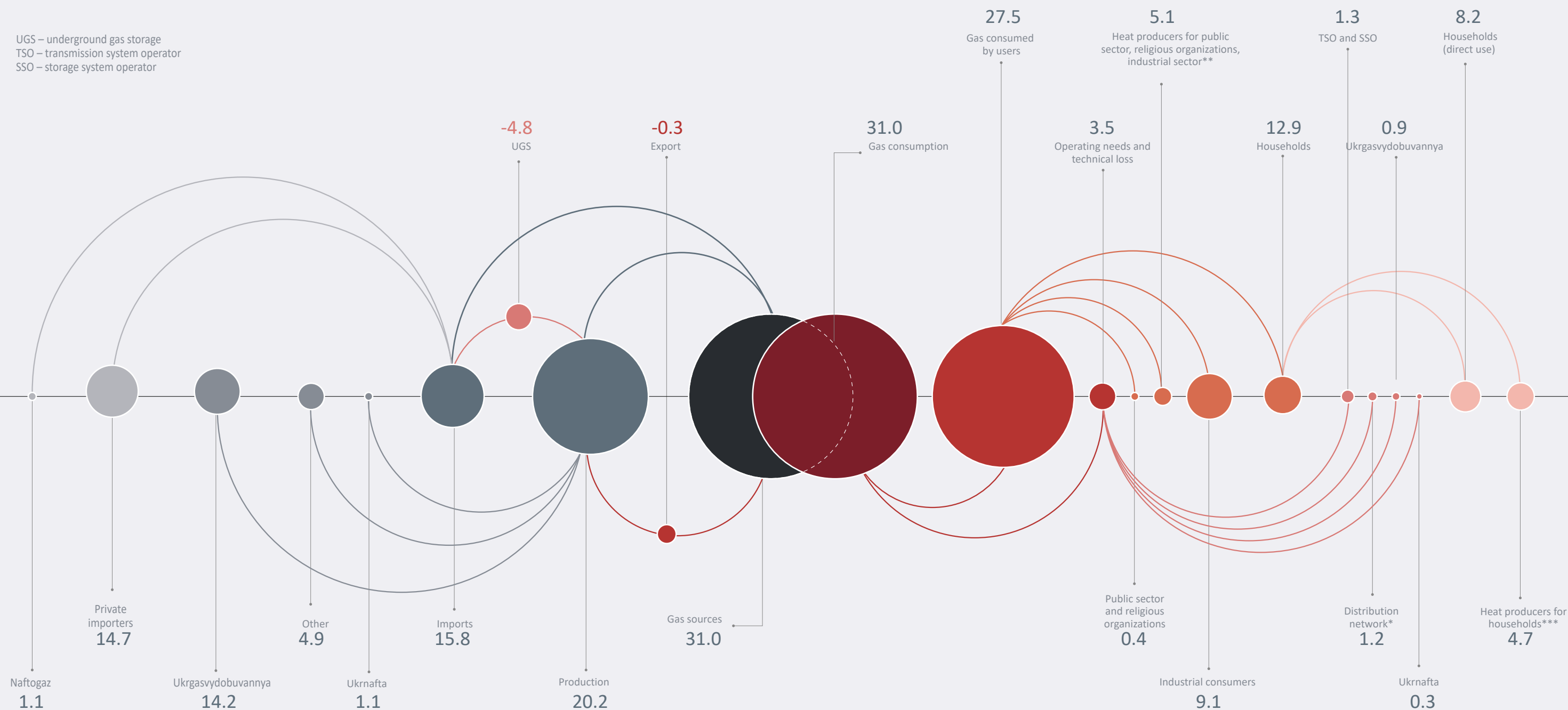
Final gas prices for households in EU and CIS countries (with VAT and transportation), UAH/cubic meter



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

Gas balance 2020

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



Gas sources

Gas consumption

* 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 9-71 per barrel against USD 53-75 in 2019. Virtually uncontrolled fall 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 9.12 per barrel (21 April, 2020), and the price of WTI – USD (36.98) 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 drop in oil demand in 2020 was 8.86% 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, consumption decreased by 6%, from 102.3 to 96.7 million bbl/day. **1**

The decline in demand for hydrocarbon resources was provoked by both cyclical and seasonal downturns in production and negative expectations amidst 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 April was USD 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 Urals prices were negative. **2**

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 12.6% 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 periods, the upward trend in prices continued in parallel with the COVID-19 dynamics. For example, in the autumn the price fluctuated against the background of

negative forecasts for the likelihood of new lockdowns in most developed countries in Europe. However, in early November, news of 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 35% to 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 69.95 per barrel (from the beginning of 2021 the price increased by 39%, from mid-November 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

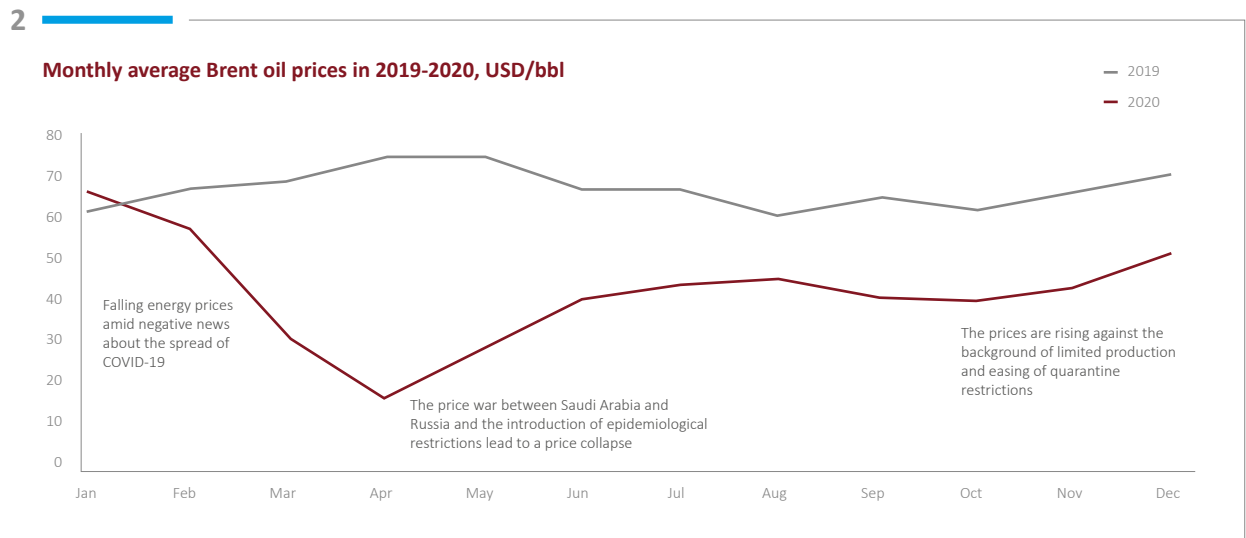
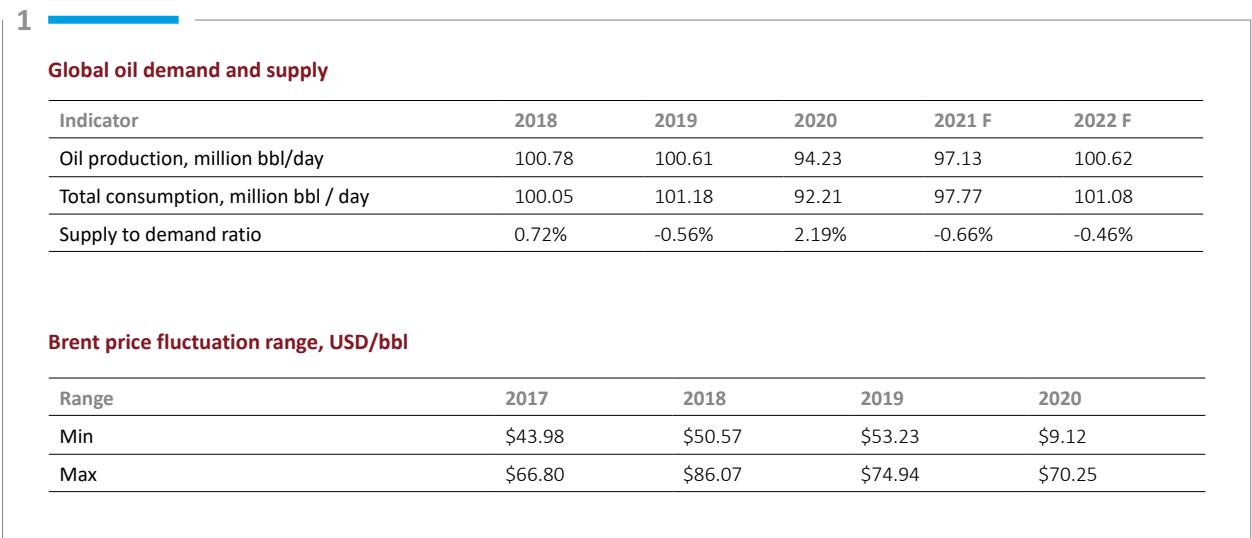
expected in the third quarter of 2021.

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 12% of the global trade supplies pass through the canal every day, including 1 million barrels of crude oil, the blockade was reflected in stock quotes. Thus, the Brent price on 23 March surged from USD 60.79 per barrel to USD 64.41 per barrel for the next day and up to USD 64.98 per barrel in a week. **3**

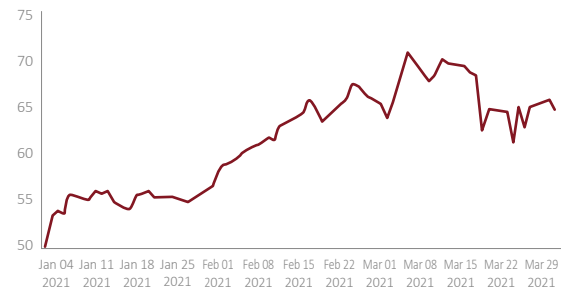
OIL PRODUCTION

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 18.3% in April 2020 to put pressure on Russia in the price war, but later it was also 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. While as of 6 March, 682 oil rigs were operating in the United States, at the beginning of May their number dropped to 325. On 14 August, only 172 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 by 15% 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. **4 5**



3

Brent price dynamics in the first quarter of 2021, USD/bbl


Source: EIA, NASDAQ

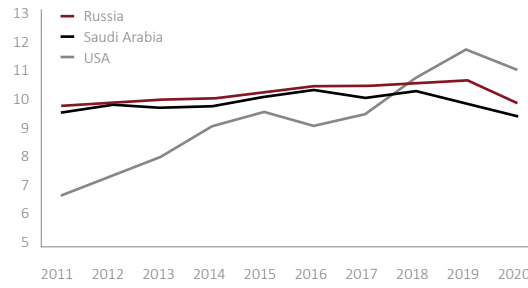
At the same time, the fall in orders from refineries contributed to an increase in oil inventories and the demand for oil storage facilities. On 19 June 2020, US commercial crude oil inventories reached a record 540.7 million bbl, which is 19% higher than in March, when the United States declared the 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. **6**

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% (2.3 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 3.85%, and of other countries – by 3.49%. At the same time, total daily production will exceed the volume produced in 2019 – 100.609 against 100.605 million bbl/day. **7 8**

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

4

Average annual crude oil production by the three largest producers, 2011-2020, million bbl/day


Source: EIA

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 (3.32%).

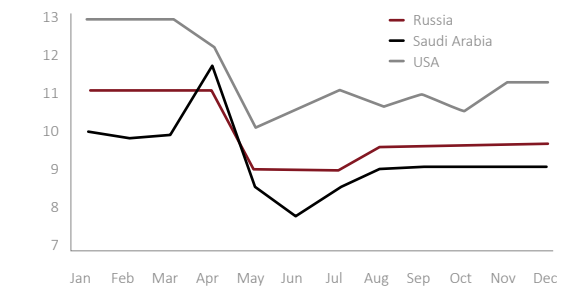
EUROPEAN OIL REFINING MARKET

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 61% from USD 5.5 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. **9**

During 2019, the price of Brent crude oil fluctuated almost synchronously with the refinery utilization rates, which allowed refiners 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.

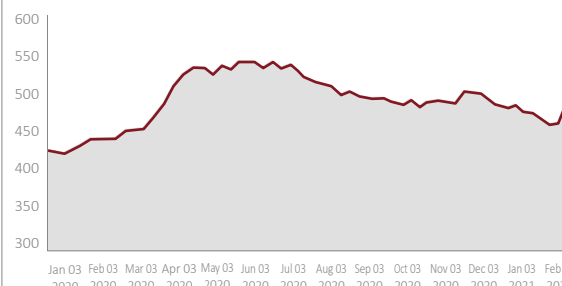
In early 2020, Europe's oil refining industry experienced a period of recovery, mainly due to planned turnarounds (technological maintenance) among the Middle East competitors. In January, the average refining margin was USD 4.96 per barrel against USD 2.54 per barrel for the

5

Monthly average crude oil production by the three largest producers, 2020, million bbl/day


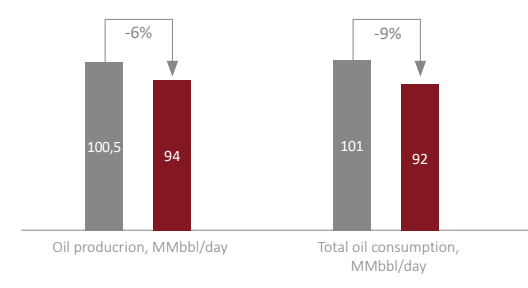
Source: EIA

6

Crude oil inventories in the United States in 2020 (excluding the US Strategic Oil Reserve), million bbl


Source: EIA

7

World oil demand and supply in 2019-2020, million bbl/day


Source: EIA

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.

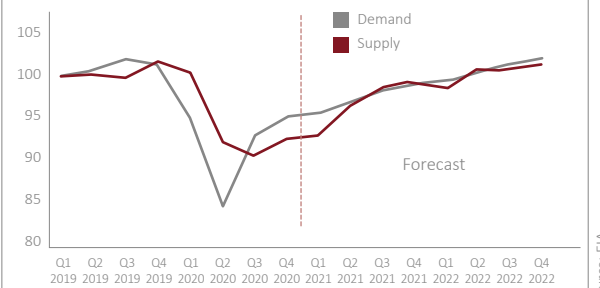
Since the beginning of spring, the low price of raw materials and the turnarounds of multiple refineries resulted in a growing refinery margin, which was under the pressure from declining demand due to the introduced lockdown. However, in May, the profitability of oil refining fell to almost zero, as 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. **10**

The coronavirus pandemic negatively affected European refining. The decline in demand for energy and fuel caused

8

World oil demand and supply in 2019-2022, million bbl/day


Source: EIA

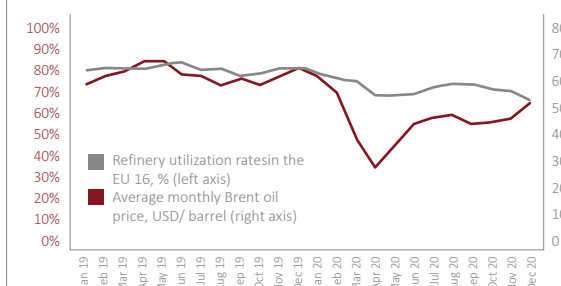
by the curtailment of business activity led to a decrease in refining margins, reduced production, and temporary decommissioning of less profitable refineries. Production of petroleum products in 2020 decreased by 10% compared to the previous year, amounting to 590.01 million tons. In the range of petroleum products, the largest changes were in production of fuel oil, which decreased by 22% to 60.3 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. **11 12**

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 own refineries. This process, however, will be in parallel to the return of the Middle Eastern and Russian refineries from maintenance inactivity to active operations.

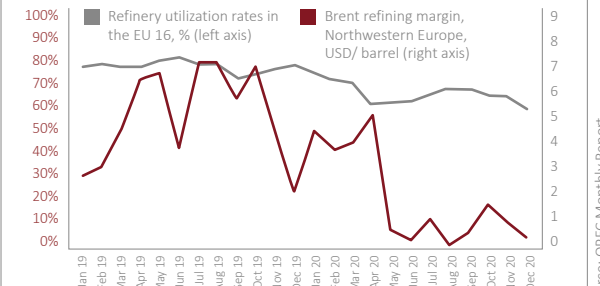
Meanwhile, markets will likely remain overstocked due to the introduction of new measures to contain the COVID-19 pandemic. According to Euroilstock, the distillate stocks in the EU-15 and Norway in November 2020 reached the highest level in 30 years. It is the increase in inventories that manufacturers, including Repsol and Gunvor, are referring to, arguing for temporary or permanent closure of their divisions. Oil refining

9

The refinery utilization rates in the EU-16 and the Brent oil price in Europe


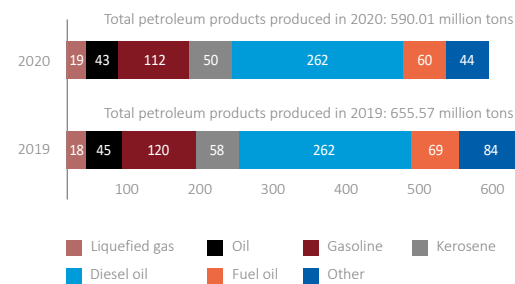
Source: OPEC Monthly Report

10

The refinery utilization rates in the EU-16 and the refining margin in Europe


Source: OPEC Monthly Report

11

Refinery output in Europe in 2019-2020, million tons


Source: IEA

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, Total, Eni and Repsol have announced the plans to reformat their own assets to produce the environmentally-friendly energy.

OIL AND PETROLEUM PRODUCTS MARKET OF UKRAINE
Oil and gas condensate production

The Ukrainian market of crude oil and gas condensate is replenished with the national product and import supplies. Naftogaz Group, which includes Ukrnafta (50% + 1 share of the company is owned by Naftogaz of Ukraine) and Ukgasvydobuvannya (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. At the same time, the Group's total performance decreased by 2.65% from 2 million tons to 1.947 million tons. **13**

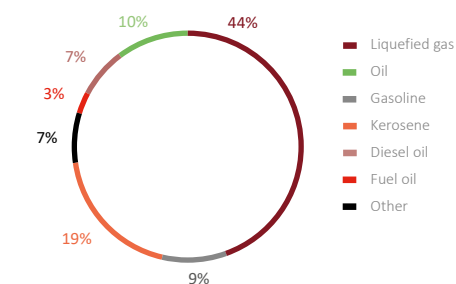
Ukrnafta was able to retain an almost identical production level compared to the previous period- 1.501 million tons against 1.52 million tons in 2019 (a decrease of 1%). Sales of products in 2020 amounted to 1.35 million tons.

In 2020, final settlements were made between Naftogaz and Ukrnafta, which contributed to the significant improvement of Ukrnafta's financial position. It is worth noting that the company is moving to new productive horizons, replaces critically worn-out equipment, optimizes its capital and current repairs of promising wells. Within the reporting period, Ukrnafta performed 4 fracturing operations, overhauled 133 wells, conducted 24 operations with the help of coil tubing units and without involving well workover crews, carried out 20 production intensity operations, and brought 107 wells back to work. In 2020, 34 wells were added to the system, and now it covers 207 wells. These measures allowed Ukrnafta to receive additional 145.4 thousand tons of output.

The gradual recovery of oil prices from the beginning of 2021 gives grounds to expect an expansion of business activities and investment programs.

Ukgasvydobuvannya reduced its annual production of crude oil and gas condensate by 7.1% – from 480 thousand tons to 446 thousand tons in 2020.

12

Petroleum output in Europe in 2020, %


Source: IEA

According to Argus, private companies increased the output by 7.3% to 472 thousand tons.

The import of crude oil to Ukraine in 2020 amounted at 1.21 million tons, of which almost 97% were delivered to the Kremenchuk refinery of Ukratnafta. 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.

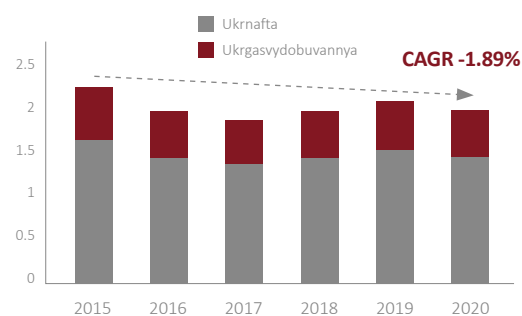
Oil refining

The largest domestic enterprises specializing in oil and gas condensate processing are the Kremenchuk refinery, which receives Ukrnafta's raw materials, and the Shebelynka refinery, which operates on Ukgasvydobuvannya product. These companies produce Euro 5 motor fuel. Operations of oil refineries in Lysychansk, Odesa, Nadvirna, Drohobych 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 Shebelynka plants increased by 232 thousand tons, or 7.5% compared to 2019, amounting to 3.34 million tons. This is the largest throughput recorded since the beginning of 2014. **14**

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 Shebelynka refinery dropped by 50 thousand tons (11% of processing in 2019) to 422.5 thousand tons. The main reason for performance

13

Production of oil and gas condensate by Naftogaz Group enterprises in 2015-2020, million tons


Source: Naftogaz Group

shortening was the reduction of processing margin in the spring of 2020. **15** **16**

Diesel fuel

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 Shebelynka plant fell by 14.8% (or 13.1 thousand tons) to 75.2 thousand tons. **17**

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 Mozyr Refinery amounted to 2.04 million tons, a decrease of 3%. According

to Argus analysts, this reduction is mainly due to the reorientation of Belarusian suppliers, including Naftan, to the Baltic countries. **18**

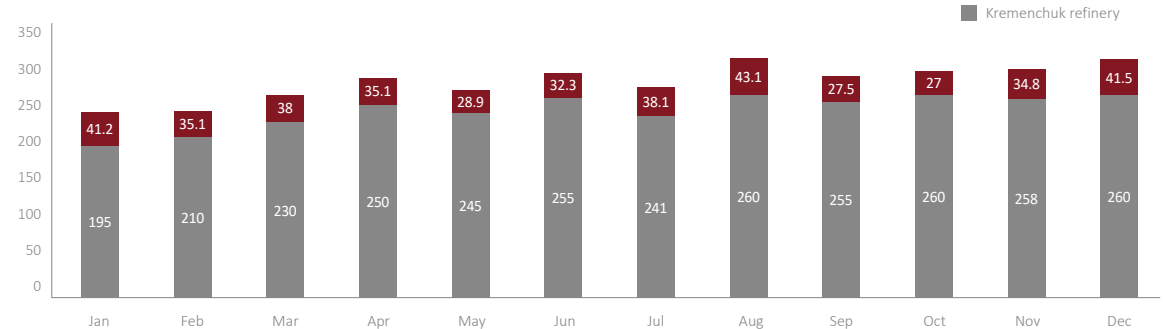
Gasoline

The estimated balance of the Ukrainian gasoline 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 decrease (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 Ukratnafta to reduce its imports of methyl-tert-butyl ether, same as the production of benzol reforming raffinate.

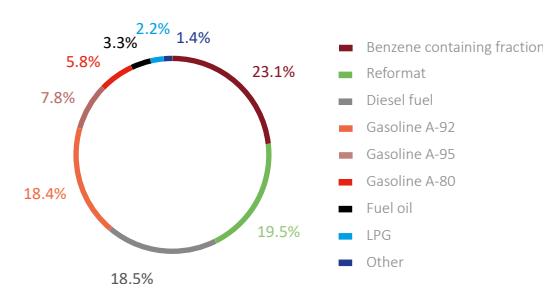
Gasoline output at the Shebelynka refinery decreased by 6.4% to 139.68 thousand tons. Whilst the production of A-92

14

Refinery throughput in 2020 at the largest Ukrainian enterprises, thousand tons


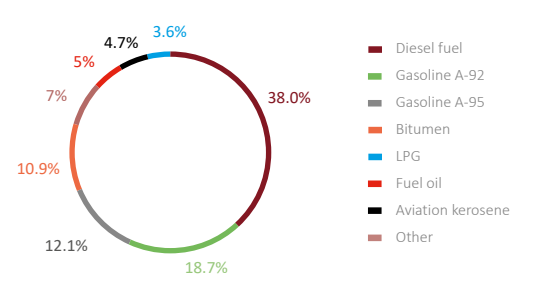
Джерело: Argus

15

Shebelynka product mix, %


Source: Argus

16

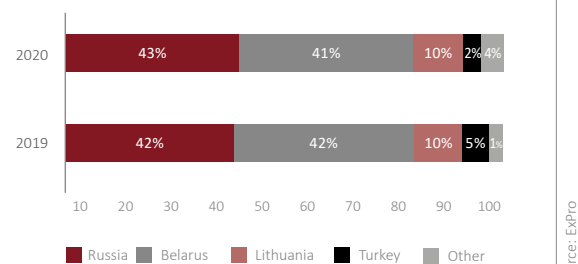
Kremenchuk refined products, %


Source: Argus

17

Diesel fuel production in 2020 at the largest Ukrainian refineries, thousand tons


18

Structure of diesel fuel exporters on the Ukrainian market in 2019-2020, %


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. **20**

According to the consulting company ExPro, gasoline imports to Ukraine in 2020 increased by 61.6 thousand tons (or 5.9%) compared to the previous year and amounted to 1.09 million tons. The largest counterparties were Belarus and Lithuania. Thus, exports from Belarus grew by 22.8% (or 158.4 thousand tons) – to 857.2 thousand tons. The main supplier was the Mozyr 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 BRSM-Nafta. Imports of Lithuanian gasoline produced by Orlen, according to ExPro, amounted to 232.2 thousand tons, which is 29.4% lower than the volume of deliveries in 2019.

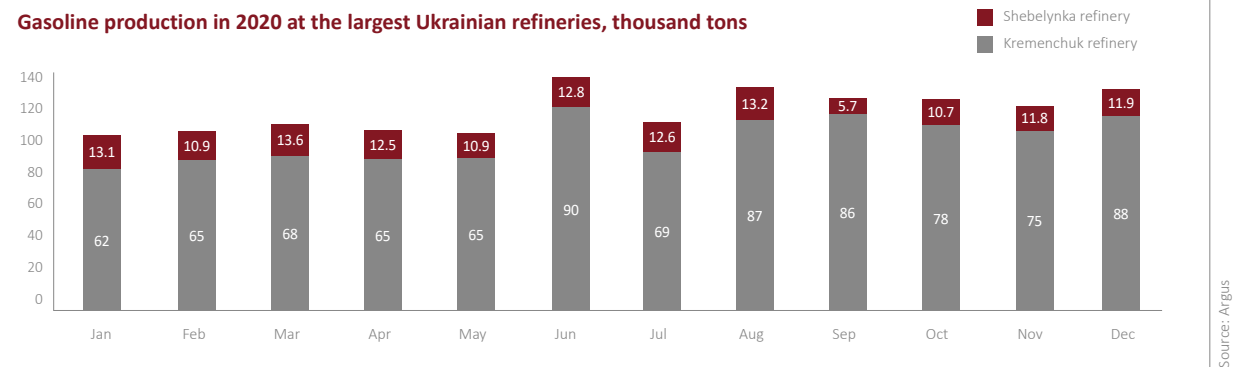
The product structure of imports was dominated by A-95 gasoline- about 68% of total deliveries. Also, 334.6 thousand tons of A-92 and minor volumes of A-100 and A-98 gasoline were imported (as per Argus statistics). **19**

Aviation fuel

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 39.5% to 138 thousand tons. In part, this reduction allowed to expand the gasoline production. Also, in 2020 the refinery switched from PT aviation kerosene to the manufacturing of Jet A-1 fuel.

20

Gasoline production in 2020 at the largest Ukrainian refineries, thousand tons


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 412.6 thousand tons of total production. At the same time, the domestic producers' performance differed.

Ukrigasvydobuvannya, 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 manufactured by Ukrnafta increased by 4.5% to 117 thousand tons. According to the consulting company A-95, the Kremenchuk refinery of Ukratnafta 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. **21**

On the other hand, the private company "Natural Resources" (part of the group "Geo Alliance") increased its LPG product volumes by 15.5% to 19.4 thousand tons. Regal Petroleum also boosted production by 26.4% to 11.4 thousand tons in 2020.

LPG imports in the reporting period rose by 5.5% (or 81.5 thousand tons) to 1.57 million tons. The largest share of imported LPG, 73.6% of the total, came by rail, 20.6 % was delivered by road. At the same time, the volume of marine LPG supplies to Ukraine reached a record 92.4 thousand tons compared to 58.3 thousand tons in 2019. Russia became the largest supplier of LNG with 721.4 thousand tons of the delivered product (4.4% more than in the previous period). At the same time, Rosneft, which holds more than half of imports from Russia, reduced its sales to the Ukrainian market

by 30.5 thousand tons. The second-largest vendor of LPG was Kazakhstan, which increased LPG exports to Ukraine by 21.4 % - to 374.7 thousand tons. Shipments from Belarus decreased by 38.5 thousand tons and reached 344.8 thousand tons of fuel. In 2020, small shares of the Ukrainian market were also occupied by counterparties from the Baltic states. **22**

Bitumen

The Kremenchuk refinery was the only Ukrainian bitumen producer in 2020, its performance is estimated at around 330.0 thousand tons. According to ExPro, during the reporting period, export shipments appeared, in particular to Moldova. The abroad sales share reached 0.2% of the total market volume- almost 2.0 thousand tons.

According to ExPro statistics, in 2020 bitumen imports to Ukraine reached a record 861 thousand tons (increased by 94.6% compared to the previous year). At the same time, 584.7 thousand tons of product (almost 68% of total supplies) came from Republic of Belarus, another 15.4% of total imports (or 132.9 thousand tons) were delivered from Poland. In 2020, the volume of supplies by sea accounted for 14.9% of total imports or 128.0 thousand tons. This supply route was used by Greece (35.6 thousand tons), Azerbaijan (32 thousand tons), Turkey (31.1 thousand tons), Italy (19 thousand tons) and other contracting countries.

Oil transit and transportation

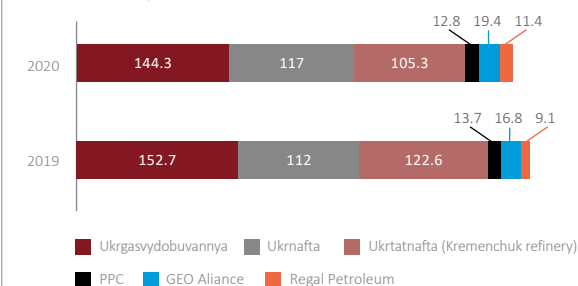
Oil transportation through Ukraine's major oil pipelines is carried out exclusively by Ukrtransnafta, which is part of the Naftogaz Group. In 2020, the volume of transportation of crude oil increased by 1.5% compared to the previous year, amounting to 15.7 million tons. Almost 2.6 million tons (8.6% 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.

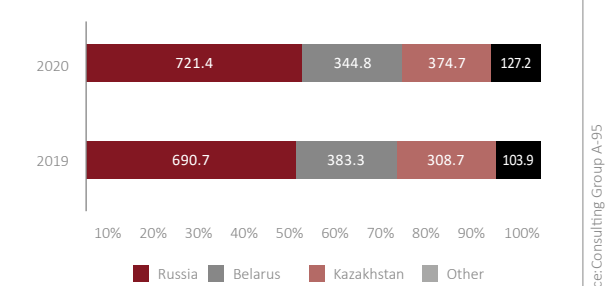
For the first time on 7 June 2020, Ukrtransnafta transported "light Texas" oil – West Texas Intermediate (WTI). The customer of this operation was the Kremenchuk refinery. In total, the company has experience in transporting five varieties of imported oil: Urals, Azeri Light, Bakken, El Sharara and WTI.

Also, in November 2020, Ukrtransnafta transported 79.9 thousand tons of oil to Belarus under a purchase agreement concluded with BNK (UK) Limited.

21

LPG production by Ukrainian enterprises in 2019-2020, thousand tons


22

Structure of LPG exporters in the Ukrainian market in 2019-2020, thousand tons


Gas Transit Organization Services

UAH 46.7 billion

net revenue of the segment in 2020

55.8 bcm

volume of Russian gas transmission through Ukraine in 2020

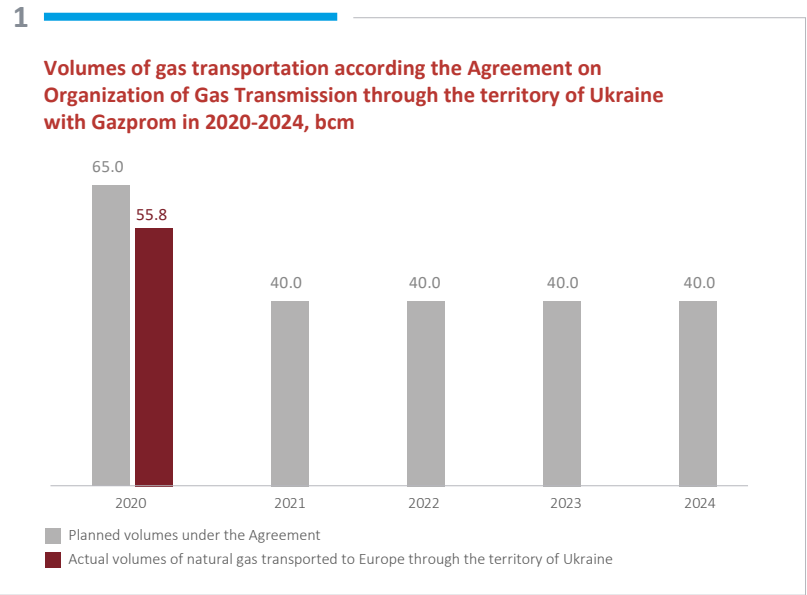


KEY SEGMENT RESULTS FOR 2020:

- 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 30.12.2019 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. 1 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:

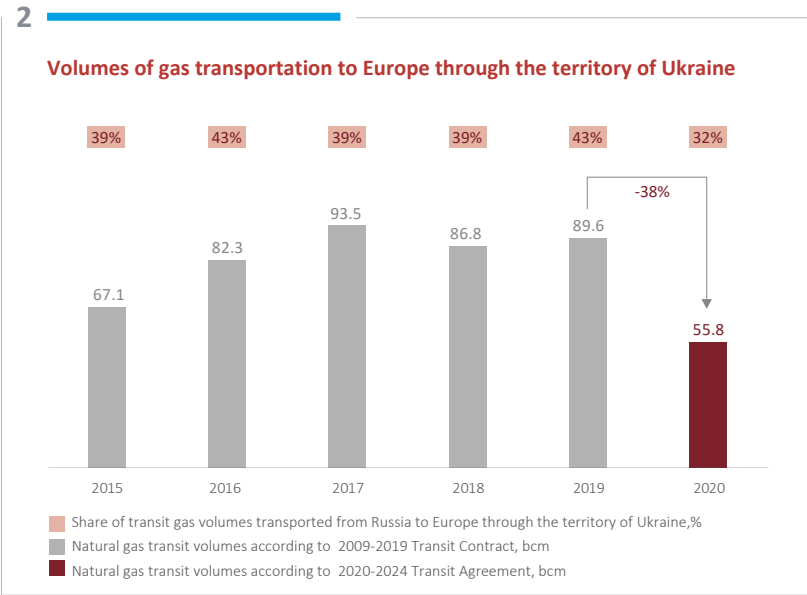


- Interconnection Agreement signed by Gas TSO and Gazprom (as the operator of the Russian GTS), which provides for technical regulations and rules of interaction between the operators of adjacent networks;
 - Agreement on the Organization of Gas Transmission through the territory of Ukraine between Naftogaz 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.



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 points 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



Sources: Naftogaz Group, GTS Operator of Ukraine, reports of the European Commission

65 bcm

booked and paid transmission capacity by Gazprom in 2020



40.0 bcm
planned booked capacity for 2021 according to the Agreement with Gazprom

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. **2** 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.

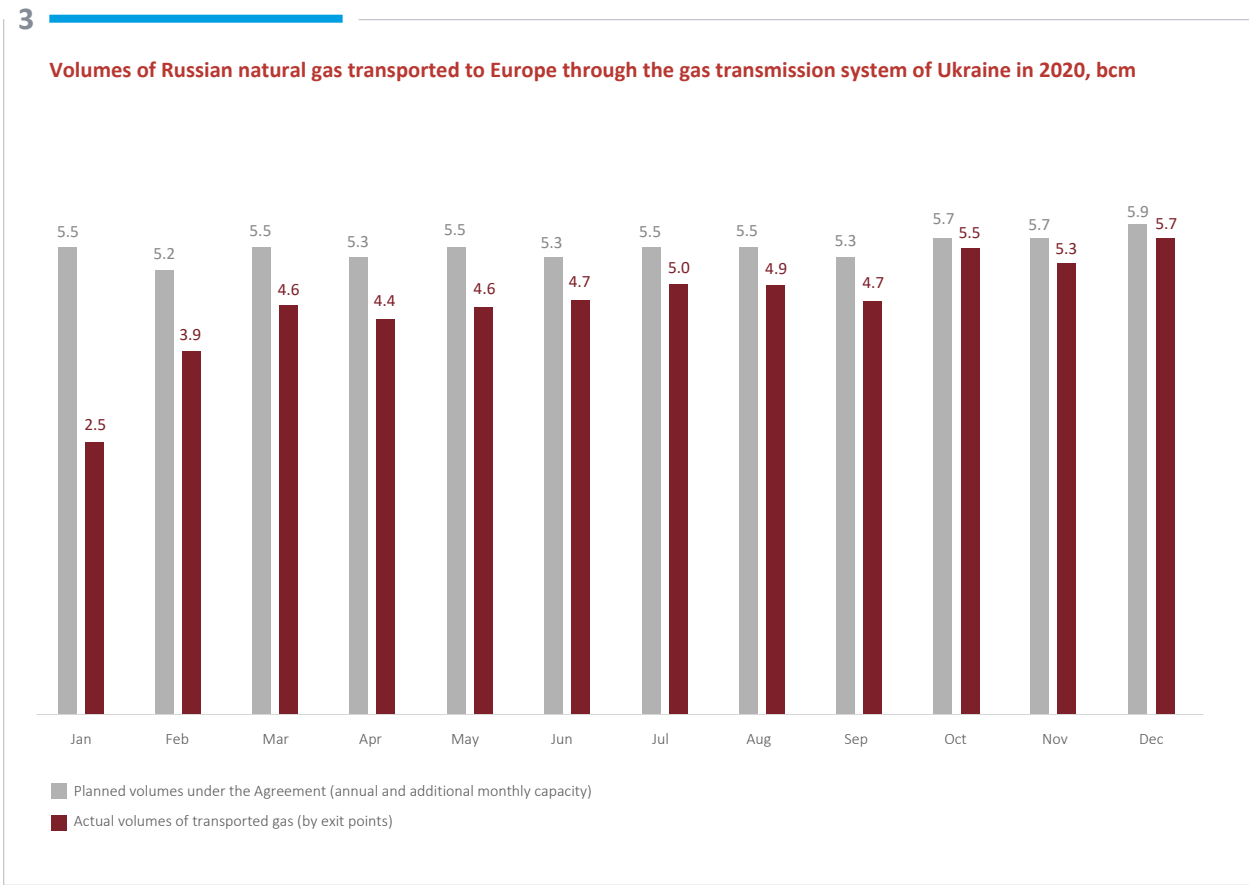
Since the terms of the Gas Transit Agreement include an advance payment of the booked capacity of 65 bcm, regardless of the actual volume of gas transportation (ship-or-pay principle), the company received about USD 2.07 billion from Gazprom for services provided in 2020 (excluding the fee for additional 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. **3**

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.

In 2020, Naftogaz fulfilled all obligations towards Gazprom and Gas TSO of Ukraine under a set of signed agreements in 2019



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 Ukranf​ta PJSC fully repaid its tax debt to the state.

Naftogaz Group made a significant step forward in subsoil 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	IMPACT OF CHANGES
<p>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.</p>	<p>Positive event</p>
<p>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).</p>	<p>Positive event</p> <p>Simplification of the procedure for changing the natural gas supplier for households fostered the development of competition and served as a prerequisite for the launch of the retail natural gas market.</p>
<p>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, religious organizations, and Artek International Children’s Centre SE, as well as the supply of natural gas to households, religious organizations, and Artek International Children’s Centre SE, supplies to which in the relevant period (delivery month) are not made by another supplier, on terms and conditions that are determined by the Provisions of PSO, approved by the CMU Resolution No 867 of 19.10.2018.</p> <p>At the same time, PSO regime was extended regarding the natural gas supply for heat supply companies until 01.05.2021.</p> <p>Initially, the natural gas market in the segment of gas supply to households was supposed to be liberalized from 01.05.2020 in accordance with Ukraine’s international obligations to the IMF. However, the Government postponed this date twice – first until 01.07.2020 (Resolution No 303 of 24.04.2020), and then for one month more, until 01.08.2020 (Resolution No 542 of 01.07.2020).</p>	<p>Positive event</p> <p>Termination of the PSO regime is a prerequisite for the establishment of a competitive retail natural gas market, which is provided for by Ukraine’s international obligations.</p>

CHANGES IN REGULATORY	IMPACT OF CHANGES
<p>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.</p> <p>In addition, on 23.09.2020, NEURC optimized the procedure for concluding a natural gas supply contract between consumers and ‘last-resort’ supplier, 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.</p>	<p>Positive event</p>
<p>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.</p>	<p>Negative event</p> <p>The ban was of a demotivating nature and had a negative impact on the Company’s counter-parties as well as for natural gas payments.</p>
<p>The Verkhovna Rada adopted the Laws of Ukraine No 1006-IX and No 1005-IX on 17.11.2020, which introduced a mechanism to compensate the costs for PSO to Naftogaz that, in turn, made it possible to pay the tax liabilities of Ukranf​ta PJSC. Due to these legislative changes, and the relevant CMU decisions, Ukranf​ta PJSC repaid its tax debt of over UAH 29 bn and Naftogaz received a compensation of UAH 32.2 bn. 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.</p>	<p>Positive event</p> <p>First of all, the issue of Ukranf​ta PJSC tax liabilities to the budget from past periods was settled, taking into account fines and pecuniary sanctions, the collection of which under other circumstances would have required a long-term legal procedure with an uncertain result for the state. In addition, the implementation of provisions of Article 11 of the Law of Ukraine “On the Natural Gas Market” regarding the compensation to be provided to natural gas market entities with public service obligations established an important precedent for the state to fulfill its obligations.</p>
<p>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 regional councils the procedure for the provision of subsoil for use to extract minerals of national importance (Resolution No 124).</p>	<p>Positive event</p> <p>The changes helped reduce the administrative burden and political influence on investors, minimize corruption risks, and stimulate the development of subsoil exploitation.</p>

CHANGES IN REGULATORY	IMPACT OF CHANGES
<p>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.</p> <p>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 (maritime) economic zone of Ukraine for a period of 30 years without auction.</p> <p>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 NJSC (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.</p> <p>The Government also approved draft agreements with JSC Ukgasvydobuvannya on sharing the hydrocarbons to be extracted within Buzivska, Ivanivska, Berestyanska 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.</p>	<p>Positive event</p> <p>Development of new oil and gas areas will contribute to the development of the mineral resource base and increase hydrocarbon production in Ukraine.</p>
<p>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).</p> <p>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).</p>	<p>Positive event</p> <p>Continuing corporate governance reform and maintaining the independence of the company’s Supervisory Board are key to effective governance and contribute to the development of Naftogaz Group.</p>
<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.</p>	<p>Negative event</p> <p>This regulation did not have the expected positive impact on the country’s economy and cast doubts on the achievement of corporate governance reform in public sector enterprises, in particular with regard to the independence of supervisory board.</p>
<p>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).</p>	<p>Positive event</p> <p>Such changes made it easier for non-resident companies to use the “customs warehouse” service and increased the attractiveness of Ukraine’s underground gas storage facilities.</p>

CHANGES IN REGULATORY	IMPACT OF CHANGES
<p>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 Andriyivka ground mounted photovoltaic power station (999.74 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.</p>	<p>Positive event</p>
<p>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.</p>	<p>Positive event</p> <p>The adopted changes contributed to legal clarity regarding the future of ‘green tariffs’.</p>



2. STRATEGY: HOW OUR BUSINESS OPERATES

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OUR STRATEGIC GOALS AND DIRECTION

The growth of our business is reliant on three strategic pillars: natural gas, energy services, and renewables. The most important pillar for the near term is the gas business including production, trading, and storage. We intend to channel most of our investments, estimated at USD 25 billion, towards achieving our goal of significantly increasing natural gas production. It is critical that we involve partners in this process.

We strongly believe in our position as a Ukrainian champion, or ‘Energy Partner of Choice.’ And with that also comes our ambition to address the climate change. First of all, we have set a target to reduce our own CO2 footprint to zero by 2040, which would be 10 years earlier than required by EU regulations. Secondly, we plan to introduce new services and products, namely electricity, energy services, and energy efficiency, for our customers. In addition, we will seek to adjust our business to become a low carbon and economic business through the development of new fuels like hydrogen, bio-based fuels, and other renewables, along with the adoption of CO2 reduction measures such as capture and storage.

Oil production is not core to our business priorities. We expect to spin off our oil production activities, organized in Ukrnafta PJSC, and focus on logistics, sales, and trading activities in the oil value chain in the medium term. Eventually, oil will become part of our legacy. We are and remain proud of our colleagues in this business who founded the energy industry.

The overall strategic approach to changing our operating model lies in our adaptability to new realities. We need to become closer to our customers. The best way to achieve this is by becoming more digitized and knowledge-oriented. As we develop a greater understanding of customer needs, we begin the transition from an asset and capital intensive company to a customer and knowledge based company. We will need to become agile in our work.

I am very proud of Naftogaz and the role it plays in the Ukrainian economy and society. I am proud of our people, who work every day to improve our business and pursue our common mission. We are led by a strong mission. Together, we demonstrate time and again our significance to the country and our ability to produce significant results. I hope Ukrainians will share my pride in Naftogaz.

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 years, 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 Yuzivska area, potential deep reservoirs, and specific production-sharing agreements, as well as partners to join existing fields.

The Yuzivska 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 overriding 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.



Over the next five to ten years, we are determined to achieve Ukraine’s self-sufficiency in terms of natural gas and independence from imports

Otto Waterlander
**Chief Operating Officer,
Chief Transformation Officer of Naftogaz Group**

Corporate strategy

HIGHLIGHTS

DRIVING GROWTH:
USD 20-25 bn investments in natural gas exploration and production

PREPARING FOR TRANSITION:
Carbon neutrality by 2040

FOCUSING ON VALUE:
Naftogaz Group target value of USD 12-17 bn

STRATEGY 10-YEAR IMPACT HIGHLIGHTS

JOBS:
273 thousand jobs created

GDP: UAH 441 billion of GDP growth

DOMESTIC OUTPUT:
UAH 791 billion of national output growth

FISCAL REVENUES:
UAH 241 billion

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 focus 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 thousand 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 gaining 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.

Source: Impact assessment study on natural gas extraction projects aimed at import substitution in the Ukrainian economy

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 to 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. **1**

- 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 it got the opportunity to develop after the PSO 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 rationalize 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 value.

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

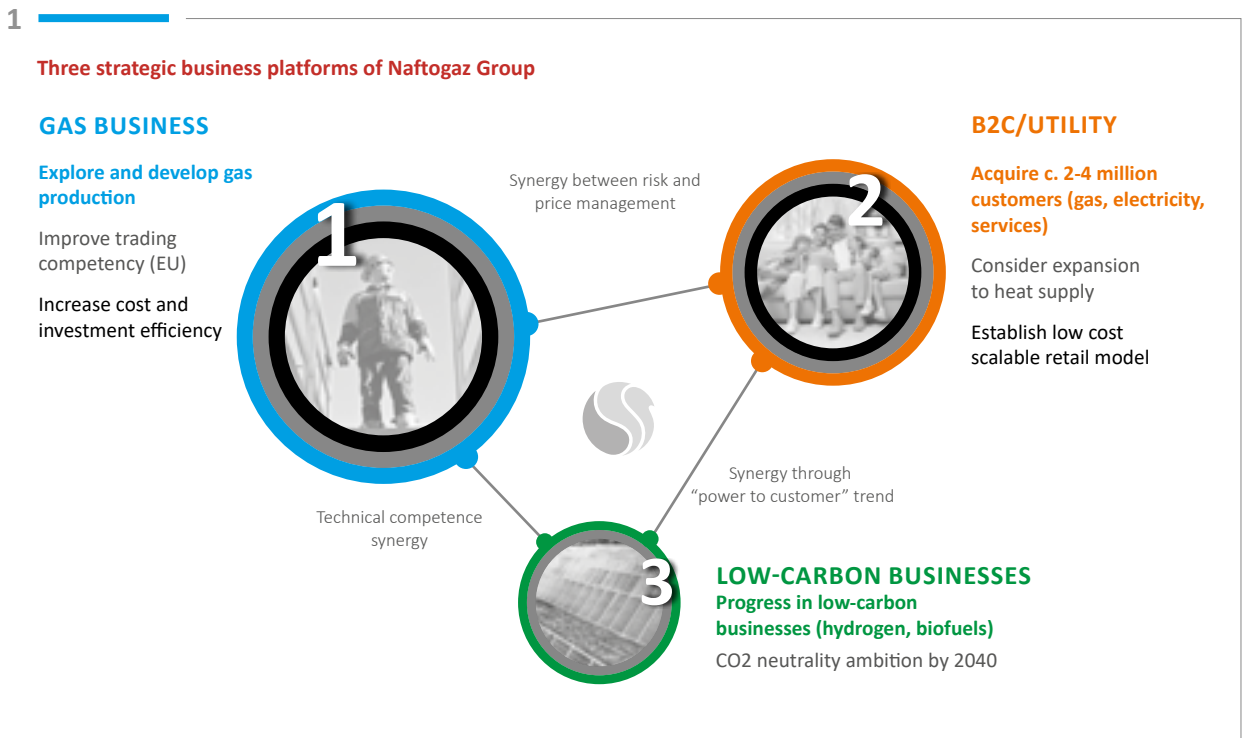
Unlocking national resource potential via partnership, knowledge, and efficiency.

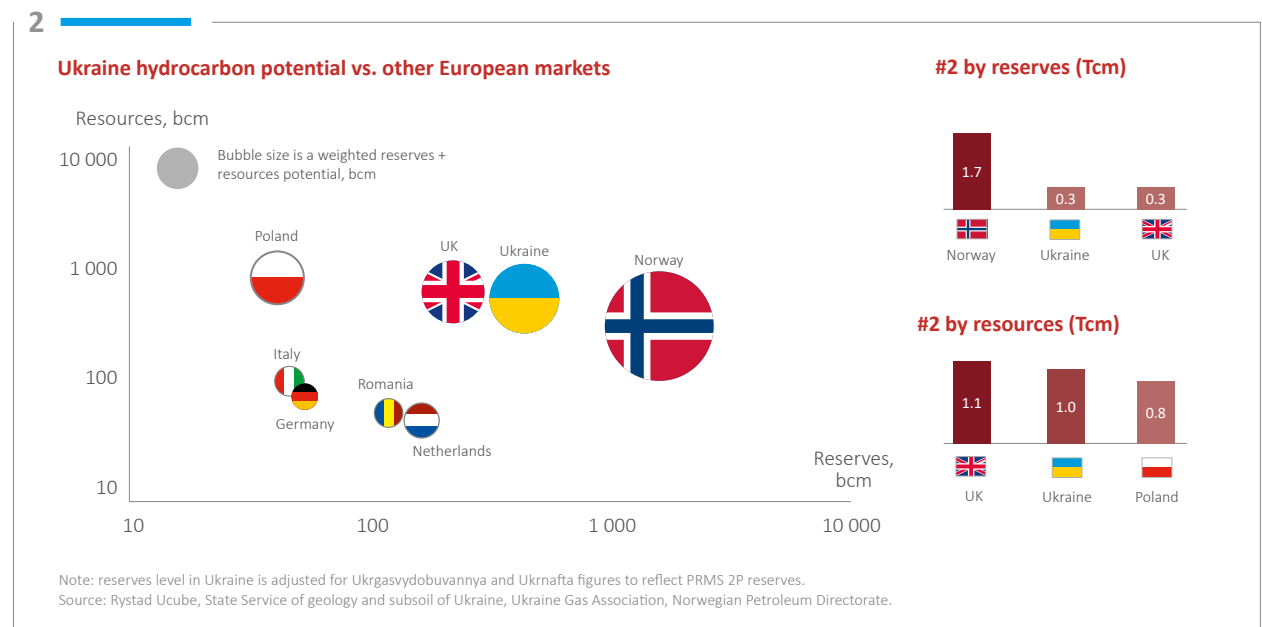
Ukraine is one of Europe’s most promising natural gas resource provinces, being #2 in Europe by reserves and resources after Norway and the United Kingdom, respectively. **2**

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.

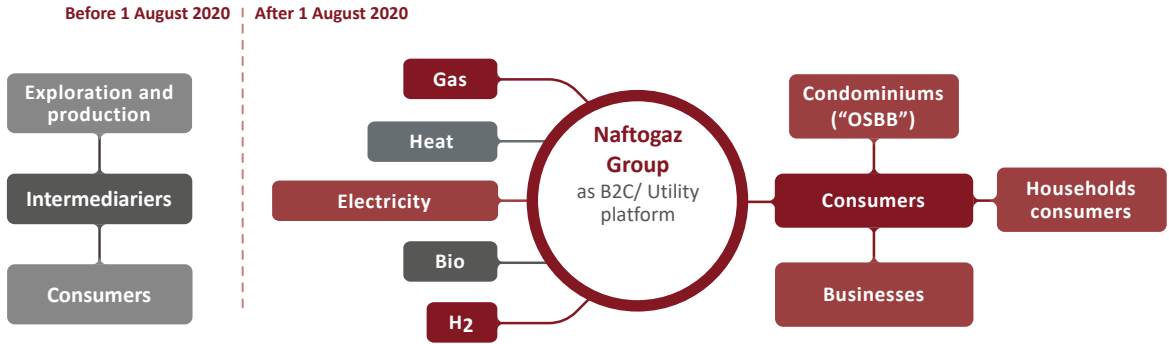
The signing of four production-sharing agreements, obtaining access to Yuzivska and Black Sea offshore opportunities, as well as pursuing new exploration areas in the Carpathians allow Naftogaz to increase production potential fivefold (measured as estimated ultimate recovery) from





5

Naftogaz as utility transformation



Source: Naftogaz Group

and move further into developing and providing competitive integrated energy solutions based on our deep knowledge of customer needs and our capabilities. **6**

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. **7**

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 Naftogaz Group's value from the low carbon business portfolio.

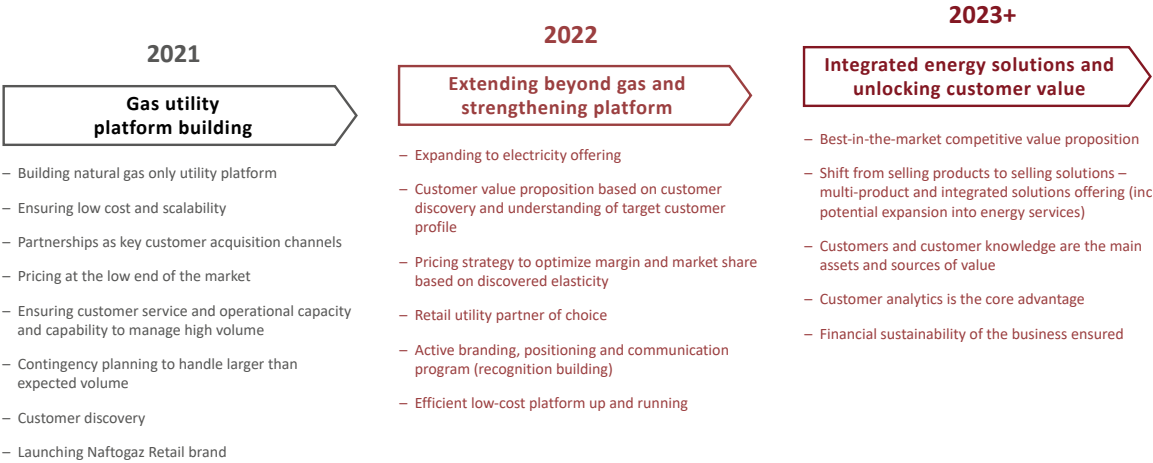
NAFTOGAZ TRANSFORMATION AND VALUE CREATION

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. **8**

Naftogaz aims to become a catalyst for the economic growth and well-being of Ukraine, which is relevant

6

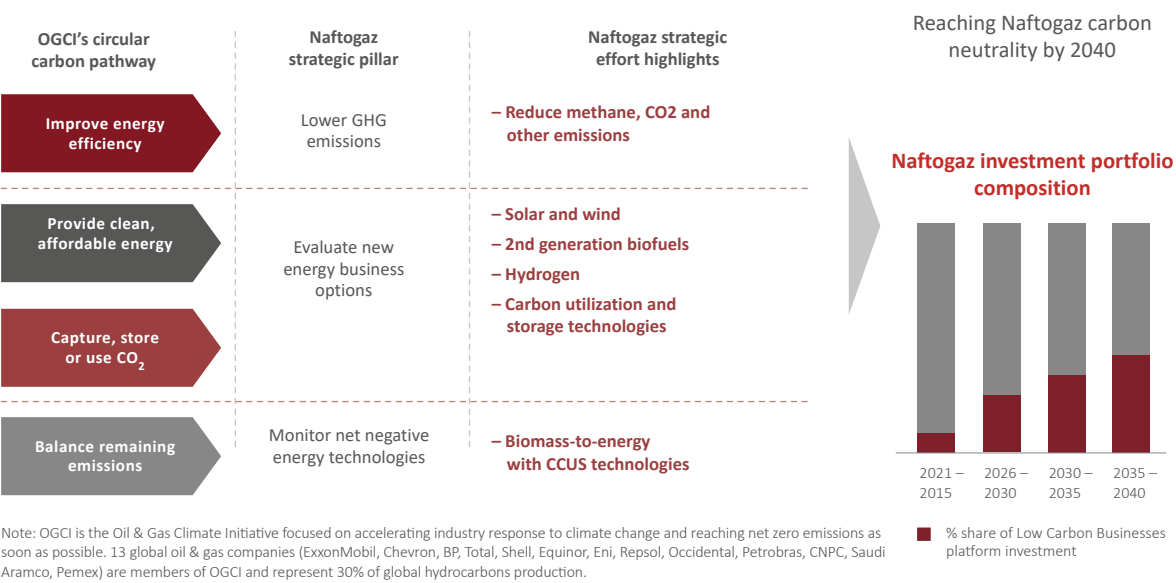
Naftogaz B2C / utility partnership rollout map



Source: Naftogaz Group

7

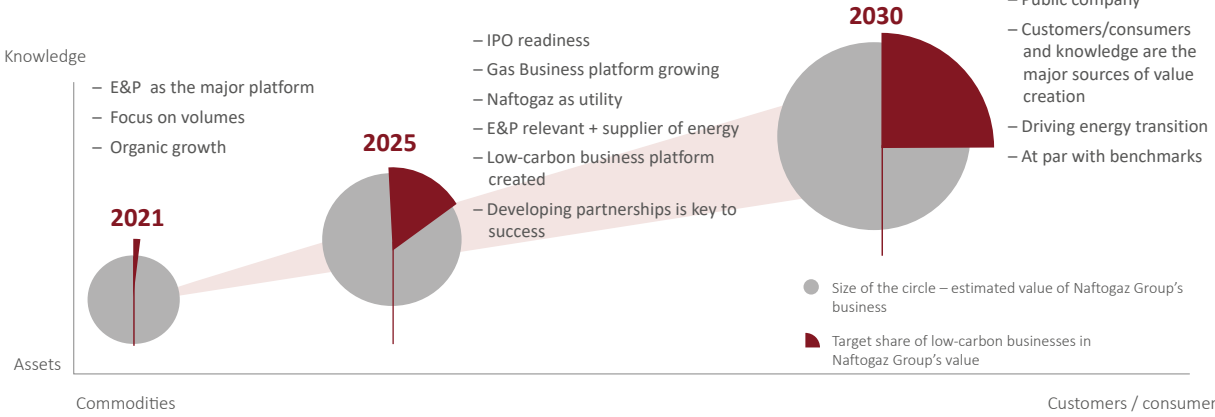
Naftogaz Group carbon neutrality ambition framework



Source: Naftogaz Group

8

Naftogaz transformation and IPO value ambition



Source: Naftogaz Group

to all stakeholders. Its strategic activities are expected to result in new job creation, partnership opportunities for financial institutions and businesses, employment and professional growth opportunities for Ukrainian talent, and improvement of quality of life 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. **9**

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 PSO 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 reform 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.

9		
Implementation of the Concept of development of natural gas production industry of Ukraine until 2020		
GOVERNMENT OBLIGATIONS	NAFTOGAZ GROUP RESULTS	JOINT WORK OF NAFTOGAZ GROUP, THE GOVERNMENT, AND THE PARLIAMENT OF UKRAINE made it possible to effectively address many challenges in 2020
✔ Awarding permits/providing access to new opportunities (most awarded only by the end of 2020)	✔ Investments into drilling equipment	
✘ Changes to the Tax Code	✔ Managing production decline at mature fields	
✘ Production Sharing Agreements (PSA) (signed in December 2020)	✔ Partnerships with international players who are ready to work with us today	
✘ From 19 Government action plan items only 1 was fulfilled in a complete and timely manner	✔ Production/reserves ratios at the level of global players with similar depletion levels	
	✔ Exploration & production experts with international experience	

NAFTOGAZ AS ENERGY
PARTNER OF CHOICE

CONSUMERS:
choose reliability
and best value



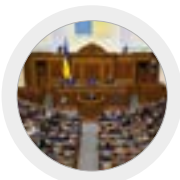
EMPLOYEES:
choose
opportunities
and stability



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.



Exploration and Production division



Oleksandr Romaniuk
Director of Exploration and
Production division

Experience with PricewaterhouseCoopers,
McKinsey & Company, EastOne Group

In line with the production increase targets assigned to the Group by the Government, Naftogaz Exploration and Production division developed, approved, and started to implement the resource base development strategy last year. In order to do this, the Exploration and Production division team was substantially reinforced.

The reshaped leadership of the division consists of managers whose expertise has been proven by successfully implemented projects in Ukraine, the USA, South America, Kazakhstan, the Caspian region, Norway, Egypt, Central and South Africa countries with international gas production and service companies such as ExxonMobil, Shell, Chevron, Halliburton, Schlumberger, etc.

Within the division, we established a geotechnical committee composed of Naftogaz Group employees to ensure better managerial decisions.

Our team was joined by world-class internal experts involved in both strategic and current production projects boasting professional experience with Eni, Shell, ExxonMobil, Vermilion Energy, and other leading companies.

We also created a board of external experts within the division to draft proposals and recommendations on field exploration and development. The board includes reputable oil and gas experts.

Management



Sanzhar Zharkeshov

Deputy Director of Exploration and
Development

Experience with Exxon Mobil, Shell, and Chevron;
was the Deputy Minister of Environment, Geology
and Mineral Resources of Kazakhstan



Oleg Tolmachev

Deputy Director of Production

Experience with BP Amoco, Chesapeake
Energy, EnCana, and Eclipse Resources



Maksym Vityk

Director of Strategic Projects

Experience with Exxon Mobil and Shell branches in
the U.S., the Netherlands, Ukraine, Russia, and Egypt



Oleksii Nesterenko

Chief Engineer

Experience – more than 20 years in senior positions
in Ukraine's oil and gas industry



Mykhailo Machuzhak

Chief Geologist

Experience – more than 40 years in geology and
exploration in Ukraine

Heads of branches



Yuriy Fesenko

Director of ShebelynkaGasVydobuvannya
Gas Production Division

Experience – more than 30 years in
UkrGasvydobuvannya and more than 20 years as the
Director of ShebelynkaGasVydobuvannya



Andriy Misinov

Director of PoltavaGasVydobuvannya
Gas Production Division

Experience – more than 20 years in various positions
with UkrGasvydobuvannya



Serhii Kryvulia

Director of UkrNDIGas Scientific
Research Institute

Experience – more than 10 years as the Director
of UkrNDIGas



Oleksandr Sendeha

Director of LvivGasVydobuvannya Gas
Production Division

Experience – more than 10 years as the Director of
LvivGasVydobuvannya

Heads of functions



Viacheslav Chaus

Deputy Director for Land and
Social Affairs

Experience in large Ukrainian national companies



Valentyn Loktiev

Geology Director

Experience with Petroleum Development Oman,
Shell (USA)



Askar Atanayev

Head Of Development

Experience in Saudi Arabia, Bahrain, Oman, Russia,
and the Netherlands with Halliburton, Schlumberger,
and Shell



Yevgeniy Stashenko

Head of Business Development

Experience in investment banking and corporate
finance in Ukrainian, US and Eastern European
markets

In-house experts



Agostino Maccagni

Chief Exploration Expert

Experience – in Italy, Egypt, the US, Norway,
Kazakhstan, the UK, and Montenegro. Worked for
Italian Eni



Peter Rolfs Tauvers

Chief Expert of Strategic Projects

Experience with Shell in various regions (the US,
Ukraine, Malaysia, South Africa, the Netherlands)
and with Arawak Energy, owned by Vitol



Martin Paul Boekholt

Seismic Survey Manager

Experience in the Netherlands, Oman, the UAE,
Russia, Kuwait, Ukraine, and Spain, in particular with
Arawak Energy, owned by Vitol, and Shell



Bryan Sralla

Chief Adviser of Strategic Projects

Experience in Vermilion Energy projects in Central
and Eastern Europe and ExxonMobil projects in
South America, the U.S., and Caspian region

Expert board

Oleksandr Akulshyn

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

Vitaliy Vitryk

General Director of RTE «Burova Technika»,
Candidate of Technical Sciences

Mykola Yevdoschuk

Doctor of Geological Sciences

Bohdan Klyuk

Candidate of Technical Sciences

Oleksandr Kondrat

Head of the Department of Oil and Gas
Production, Ivano-Frankivsk State Technical
University of Oil and Gas, Doctor of Technical
Sciences

Yuriy Krupskiy

Doctor of Geological Sciences, Candidate of
Geological and Mineralogical Sciences

Sergiy Kurovets

Vice-Rector for Scientific and Pedagogical
Work of Ivano-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 Muzychko

Geological engineer, academician of
UNGA, specialist in the field of oil and gas
development

Ilya Rybchych

An experienced manager in the gas industry,
a scientist-inventor in the field of subsoil use

Ilya Fik

Head of the Department of Oil, Gas and
Condensate Extraction, NTU «KhPI» and the
Department of Geology of KhNU named
after V.N. Karazin, Doctor of Technical
Sciences, Candidate of Geological and
Mineralogical 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 Ukrgasvydobuvannya), 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 50%, Naftogaz Group by joint efforts minimized the rate of production decline;
- The unit's EBITDA stood at UAH 27.99 billion with EBITDA margin level of 50% compared to 2019 EBITDA of UAH 43.69 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;
- An external Expert Council of eleven leading domestic scientists and practitioners in the field of exploration and production of hydrocarbons has been established;
- 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 Yuzivska area; (3) signing 4 production-sharing agreements (PSA);
- 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;
- 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.

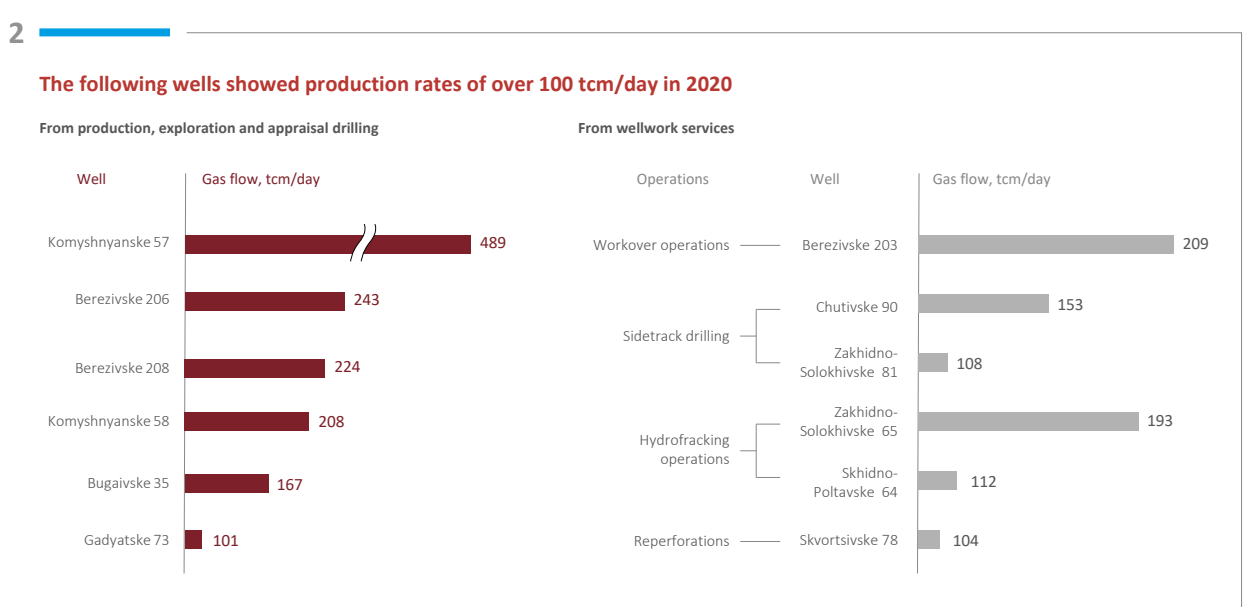
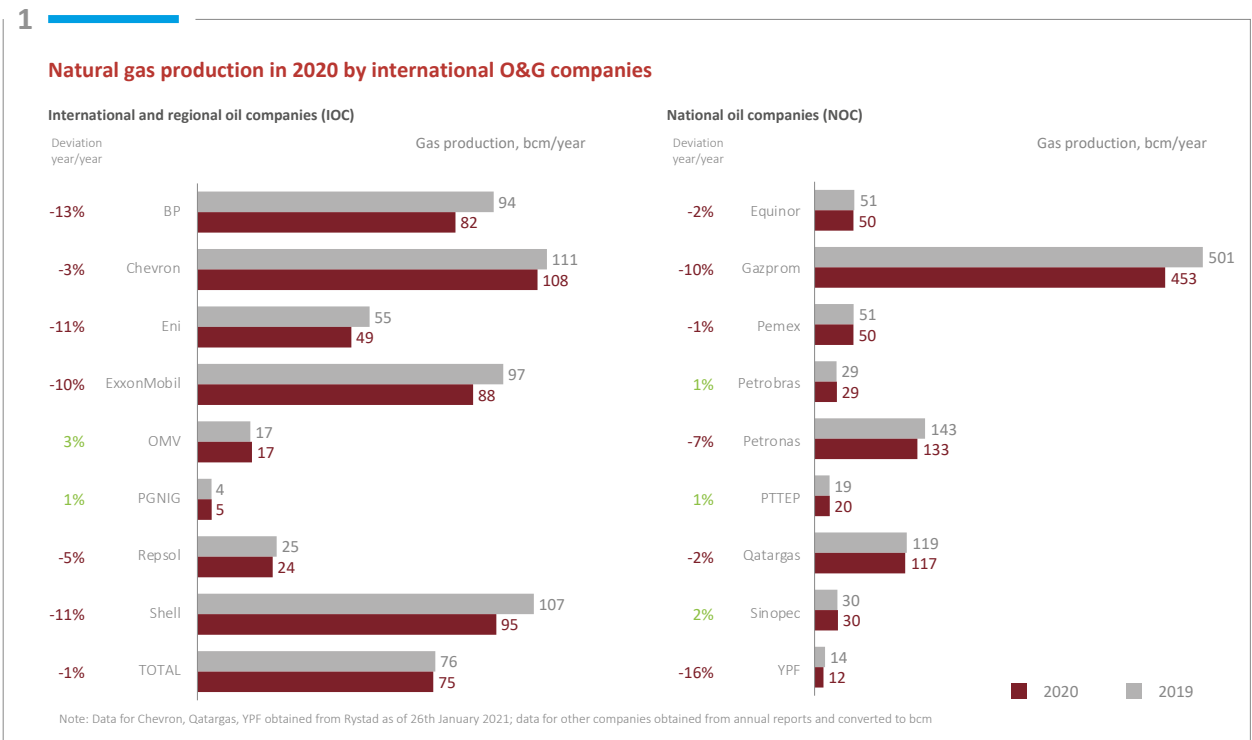
Year of challenges and anti-crisis steps

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.

The turbulence of 2020 has led to a crisis in the international oil and gas market and has become the most difficult in the last

decade, due to a sharp and unpredictable collapse in natural gas and oil prices as a result of declining demand after the start of COVID-19 pandemic and inconsistencies within OPEC+. This collapse has led to a significant decline in operating results for 2020 of most international oil and gas companies.

Trends in the global oil and gas market were also reflected



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.

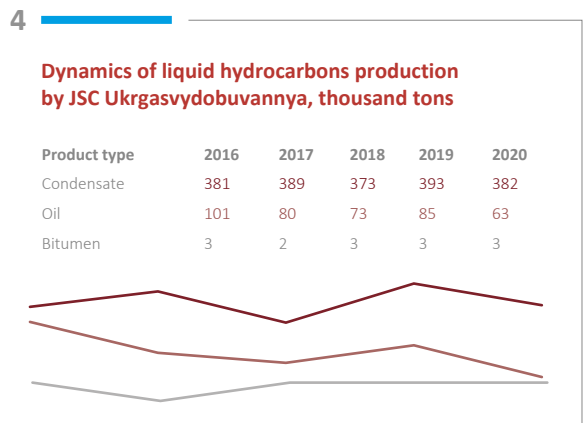
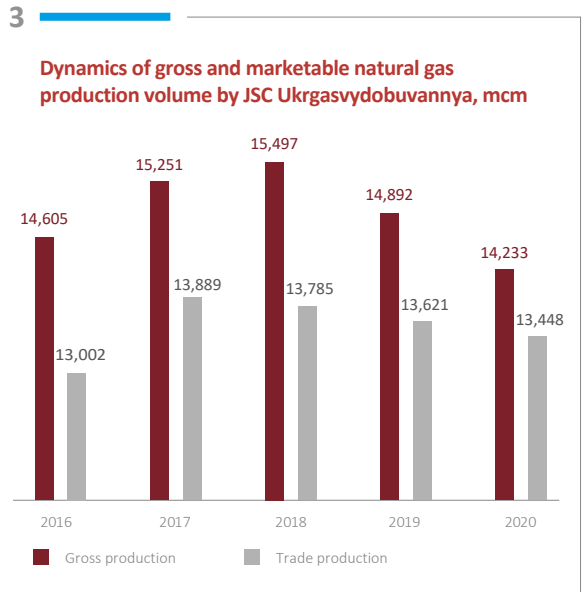
To ensure this level of production, the division team had to overcome ~1.9 bcm of base fund production decline. To compensate, teams from Exploration and Production and Technical divisions conducted the following operations on the base fund and put into operation the following quantity of wells: 178 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 division teams started full scale cooperation with LLC Halliburton Ukraine (subsidiary of Halliburton, 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



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Key levers for optimization of existing depleted field management

Naftogaz Group mature fields stewardship excellence	Field focus and accountability	Modernization of surface infrastructure	Implementation of production digitalization program	Disciplined cost management
	<ul style="list-style-type: none"> Well-based to field-based production management philosophy change Dedicated field teams with resources and accountability Reservoir life-time production and recovery optimization 	<ul style="list-style-type: none"> Modernization of booster compressor stations Pressure optimization and infrastructure downtime reduction Production debottlenecking 	<ul style="list-style-type: none"> Completion of 3D seismics and 3D reservoir models development Field and data digitalization -> "digital field" vision Surface infrastructure operation digitalization 	<ul style="list-style-type: none"> Introduction of disciplined cost accounting and analytics by field Implementation of large-scale lifting and other operating cost optimization

Source: Naftogaz Group

Chervonodonetsk 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 International 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 next years. **5**

At the date of report issuance, DeGolyer and MacNaughton 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 reserve replacement volume stood at 5.9 bcm, and is the highest for the last 4 years.

Year of continued transformation and implementation of new operational model for Exploration and Production division

In addition to external turbulence, 2020 was a year of continued transformation within Naftogaz Group, including the Exploration and Production division.

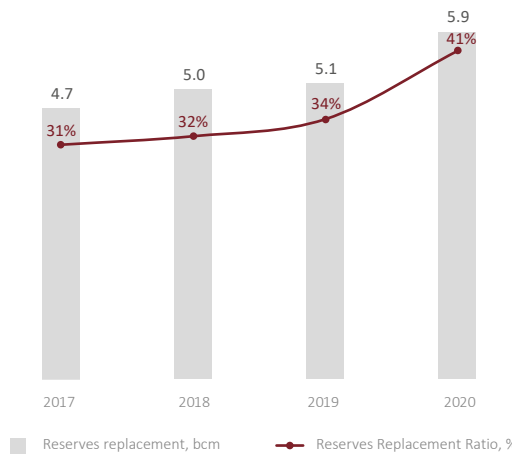
In 2020, active work was carried out to develop a new operational model for the unit, which would combine management of the existing portfolio of fields and the study of new opportunities to increase the resource potential of the Group. The main transformation is the change of focus for production management, from well-oriented to asset-based model. To implement this change, a new organizational structure of the division was developed and specialists with substantial international experience in the leading companies of the global oil and gas industry were appointed to the key positions.

Features of the new organizational structure:

- (1) fully reloading exploration and development of fields and production competencies – new managers with international experience attracted, audit of competencies performed and restructuring of teams started;
- (2) creating new competencies of the unit from scratch – strategic projects department (covering unconventional hydrocarbons, strategic offshore projects, etc), department for petroleum economics and others;
- (3) R&D center created – unique innovative institute for geological, appraisal, and exploration activities;
- (4) Created teams for field supervision to manage field life cycle and production optimization. As of the date of this report, these teams covered the 40 largest acting fields and 10 greenfield licenses. Each field management team consists

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Dynamics of 2P reserves replacement for JSC Ukrgasvydobuvannya



Source: Naftogaz Group

of a reservoir engineer, a geologist, a petrophysicist, and an extraction technologist for existing fields or a seismic geophysicist for greenfields.

One significant breakthrough towards developing R&D competence in 2020 was the opening of a modern center for 3D modeling and field visualization on the basis of UkrNDI-Gaz. In terms of the level of technical equipment, the number of specialists, and the scope of work, this is a unique center of competence for the oil and gas industry of Ukraine. Over 50 workplaces for modeling were prepared in the institute, making it the largest team of its kind in the country. 3D field models built by Center's specialists make it possible to clarify the geological structure of hydrocarbon deposits, confirm their resource potential, and plan development programs for effective management decisions on drilling new wells, optimizing production, and implementing new infrastructure.

In addition, for synergy of experience and competencies within the Exploration and Production division, an External Expert Council was established- an advisory body consisting of 11 leading domestic scientists and practitioners in the field of exploration and production of hydrocarbons. The colossal scientific and practical experience of domestic specialists who have unique knowledge about the subsoil of Ukraine will allow them to develop recommendations and proposals for exploration and development of deposits,

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 pyramid 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.

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 strategic initiatives of Naftogaz Group to increase the resource base*).

DEVELOPMENT OF BLACK SEA POTENTIAL

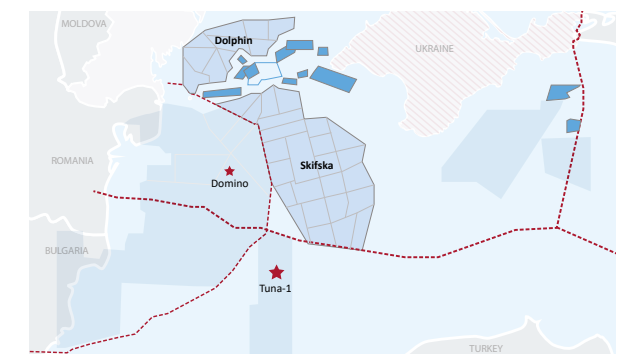
At the end of 2020, the Cabinet of Ministers of Ukraine adopted a resolution «On Amendments to the Procedure for Issuing Special Permits for Subsoil Use», which gave NJSC Naftogaz of Ukraine the right to explore and extract oil and gas on the Black Sea shelf. This decision shall help unlock the existing potential of Ukraine's subsoil, grow the economy, fill the budget, and attract investment. It represents the start of one of the most ambitious project 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 Skifska area and the Dolphin 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,

two significant discoveries have been made: (1) in 2012, the Neptune block on the Domino field (Romanian shelf) with a total EUR of ~100 bcm; (2) in 2020, the "Tuna-1" ("Sakariya") block on Turkey's Black Sea shelf with total EUR of ~320 bcm. Taking into account the resource potential of these discovered

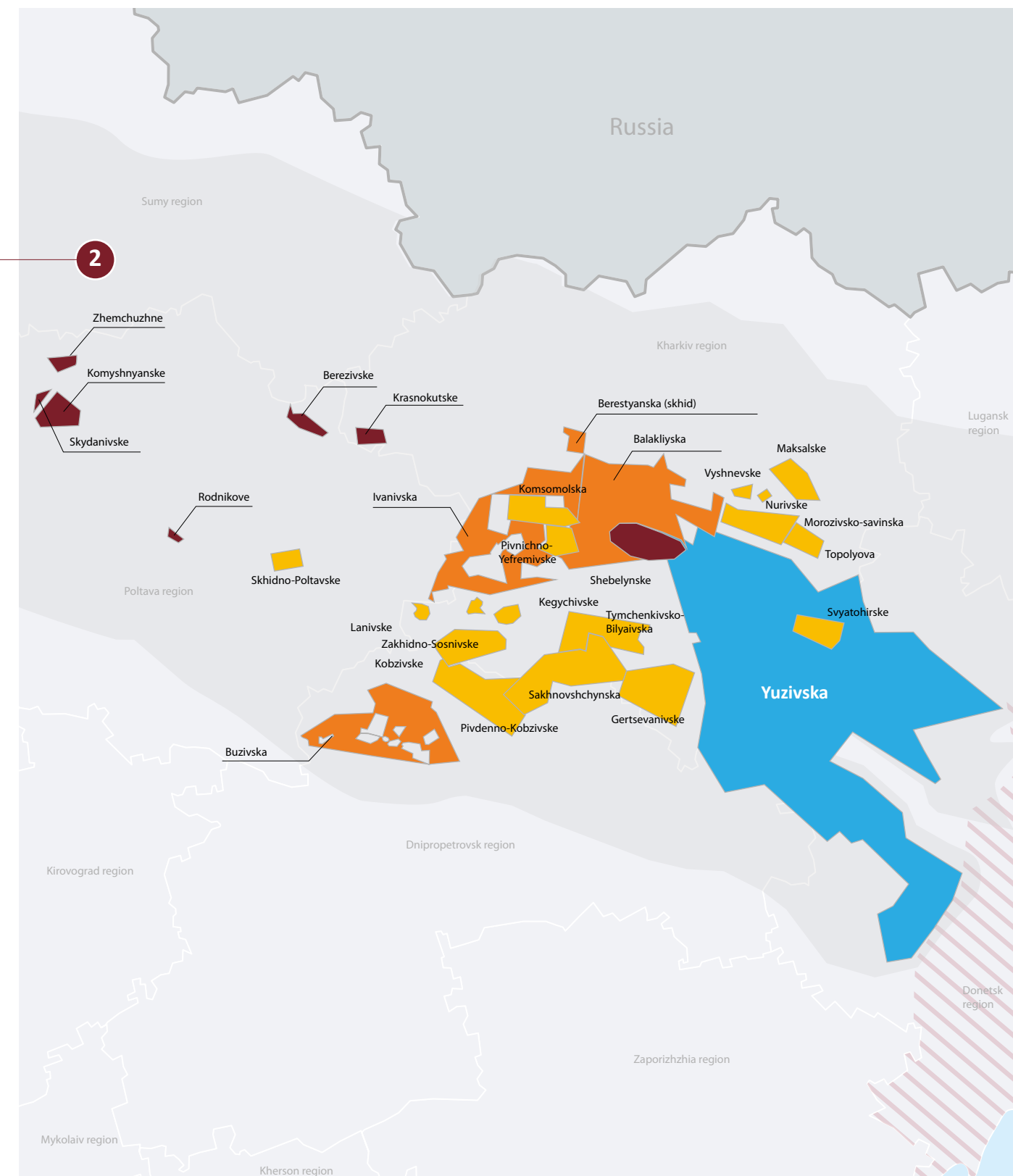
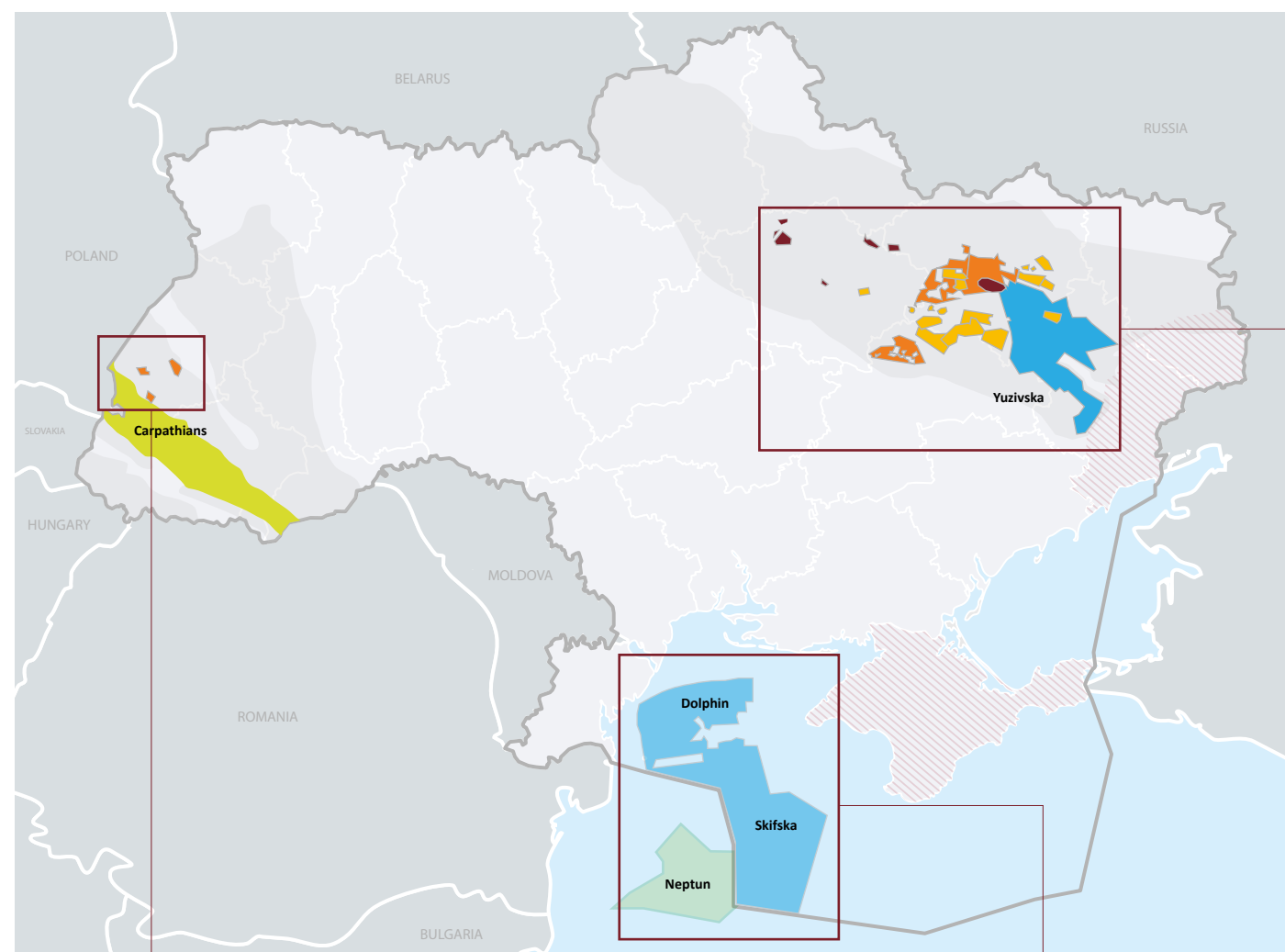
Map of Black Sea potential



Total licenses: **37**
Total area: **29,000** sq. km
Regions: Odessa
Depth: Shallow: <**150** m, Slope: <**1,000** m,
Deep water: <**2,000** m
Type of deposits: conventional collectors
EUR (P50)*: ~ **200** bcm

* EUR - estimated ultimate recovery assessed with probability 50% (P50)

Map of strategic initiatives of Naftogaz Group to increase the resource base



1 PSA areas in Western region

2 Tight gas

3 Black Sea shelf

Carpathian region

Black Sea shelf

Tight gas field portfolio

Fields under PSA

Yuzivska area

Deep horizons gas field portfolio

blocks, internal calculations of EUR for the Skifska area and Dolphin are estimated at ~200 bcm.

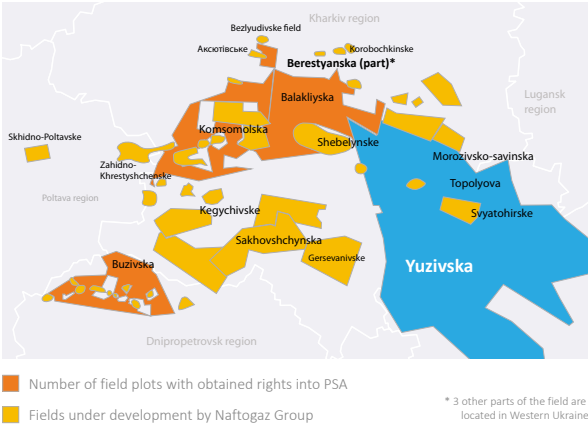
DEVELOPMENT OF FIELDS UNDER PRODUCTION-SHARING AGREEMENTS (PSA)

In 2019, Naftogaz Group won the right to conclude four production sharing agreements- Balakliyska and Ivanivska, Berestyanska, 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 1.55 thousand square kilometers and drill 12 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 Balakliyska and Ivanivska areas, which were previously planned to be shared with a foreign partner.

About the fields under production-sharing agreements
Balakliyska area is situated in Kharkiv region and borders two of the largest by production and 2P reserves fields of JSC Ukrgasvudobuvannya - Shebelynske and Efremivske. The area totals 1,119 square kilometers with average well depth of approximately 6,000 meters. According to internal expert estimates, the potential EUR of this area is 19.6 bcm of gas.
Ivanivska area is situated in Kharkiv region and borders the following fields of JSC Ukrgasvudobuvannya - Zahidno-Khrestyshchenske, Melykhivske, Medvedivske and Kotlyarivske. The area totals 842 square kilometers with average well depth of approximately 5,000 meters. According to internal expert estimates, the potential EUR of this area is 13.2 bcm of gas.
Buzivska area is situated in Kharkiv and Dnipropetrovsk regions and borders several small fields of JSC Ukrgasvudobuvannya. The area totals 670 square kilometers with average well

Map of fields included in PSA agreements



depth of approximately 4,000 meters. According to internal expert estimates, the potential EUR of this area is 10.7 bcm of gas.
Berestyanska 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 6.71 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, Komyschnyanske, Berezyvske, and Krasnokutske, 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 Zhemchuzhne, Skydanyvske, and Rodnikove. At the beginning of 2021, a new well Zhemchuzhna 1 with initial production rate of 100 tcm/day was put into operation and active drilling performed at Skydanyvske area.

A significant event was the start of drilling at the Shebelinske 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 E&A wells related to this initiative are planned for drilling.

* EUR - estimated ultimate recovery assessed with probability 50% (P50)

DEVELOPMENT OF YUZIVSKA AREA

Yuzivska area is located in the Dnieper-Donetsk oil and gas basin in the Donetsk and Kharkiv regions with a total area of 7,918 square kilometers. The area is characterized by the presence of both traditional and tight gas deposits. The site borders on the Svyatogirskie field of JSC Ukrgasvudobuvannya, the flagship in the development of tight gas fields.

Total licenses: **4** (Balakliyska, Ivanivska, Berestyanska, Buzivska)

Total area: **2,918** sq. km

Regions: Poltava, Kharkiv, Lviv, Ivano-Frankivsk

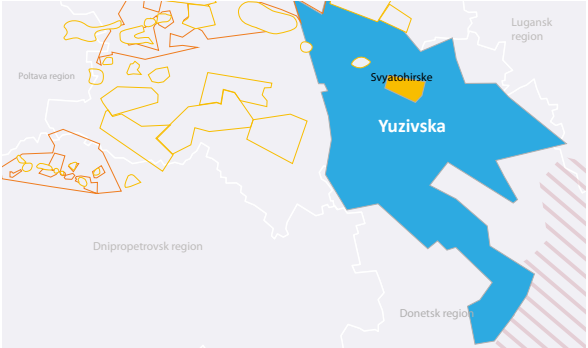
Depth: **4-6** km (East)/**2.5** km(West)

Type of deposits: conventional collectors

EUR (P50)*: **50** bcm (natural gas) + **4** m tons (oil)

* EUR - estimated ultimate recovery assessed with probability 50% (P50)

Map of Yuzivska area



In January 2013, State, Shell Exploration and Production Ukraine Investments (IV) B.V. (further- Royal Dutch Shell) and LLC Nadra Yuzivska signed an agreement on production-sharing that assumed search, exploration, and development of hydrocarbons at Yuzivska area and performed initial geological studies, in particular reprocessing and reinterpretation of 2D and 3D seismic studies. In September 2015, Royal Dutch Shell exited the agreement due to military actions in Eastern Ukraine.

In December 2020, Naftogaz Group and NJSC Nadra of Ukraine signed a sale agreement for 99% of statutory capital of LLC Nadra Yuzivska. This company holds the right for exploration and development of hydrocarbons in the Yuzivska area. Additionally, Naftogaz Group conducted an agreement to buy 1% of statutory capital of LLC Nadra Yuzivska that belongs to subsidiary of NJSC Nadra of Ukraine- Ukrainian geological scientific-production center. As a result of these transactions, Naftogaz Group became the sole owner of LLC Nadra Yuzivska.

DEVELOPMENT OF TIGHT GAS FIELD PORTFOLIO

Naftogaz Group actively works on achieving commercial effectiveness of tight gas development through a disciplined approach to reducing development risks, application of leading technologies (including horizontal drilling technologies), reduction of drilling costs, and completion of wells by standardization/optimization.

In 2020, Naftogaz Group launched the first tight gas field, Svyatogirskie, which is located in the center of the Yuzivka area, and is a pilot project within the strategic direction for the development of tight gas deposits. The start of Svyatogirskie field operations became possible after completion of modern infrastructure construction, namely the installation of integrated gas treatment unit with a maximum daily capacity of 1 million cubic meters of gas, as well as a gas pipeline 26 kilometers long. Currently, three exploration wells are connected to this infrastructure.

To further reveal the potential of the field, the unit conducted wide-azimuth 3D seismic surveys and, as a result of data interpretation, drills the Svyatogirska 12 well. Based on drilling results, a decision on the further development program of the field will be made.

DEVELOPMENT OF CONVENTIONAL GREENFIELDS

At the end of 2020, the Exploration and Production division had 56 greenfield licenses majority of which have perspective

Total licenses: **1**
Total area: **7,918** sq. km (the largest asset on Ukrainian onshore)

Regions: Donetsk, Kharkiv

Depth: **4-6** km

Type of deposits: conventional and unconventional collectors

EUR (P50)*: ~ **190** bcm

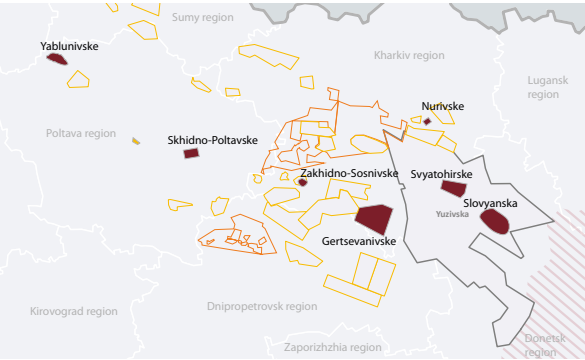
* EUR - estimated ultimate recovery assessed with probability 50% (P50)

resources at various stages of development with a total area of 10,000 square kilometers in its portfolio. The division is actively working on a detailed analysis of the licenses available in the portfolio and their prioritization for further focus, primarily on the most promising areas. In addition, measures are taken to reduce the risks of hydrocarbon exploration (seismic surveys, exploration drilling, etc.) to fully understand the potential of the sites, and, as a result, to develop further algorithms (large-scale development of the site or return of licenses to the State). According to internal expert estimates, conventional greenfield EUR is ~ 36 bcm (including only licenses with positive economics and assuming exploration success).

EXPLORATION OF CARPATHIAN POTENTIAL

The Carpathian region is a complicated asset for geological studies and exploration, first of all due to complex mountain condi-

Map of tight gas fields



Total licenses: ~ **20** blocks/fields

Total area: over **3.5** thd sq. km

Regions: mainly East of Ukraine

Depth: **4-6** km

Type of deposits: unconventional collectors

EUR (P50)*: ~ **43** bcm

* EUR - estimated ultimate recovery assessed with probability 50% (P50)

tions and the remoteness of oil & gas infrastructure. Nevertheless, the positive experience of Poland in exploration of this region (for example, based on 3D seismic studies, PGNiG increased resources of Przemysl fields by 2.5 times) gives cause for optimism in the assessment of the region's gas potential.

To date, Naftogaz Group has signed memorandums 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.

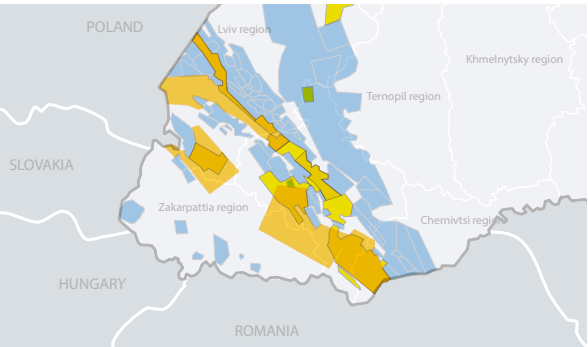
The abovementioned strategic initiatives are poorly studied and insufficiently researched, and therefore, according to preliminary estimates, their successful implementation will require investments of USD 20-25 bn over the next 10 years - USD 17.3 bn of which is investment in the development and industrial production of new deposits, with USD 4.2 bn required for the portfolio of existing deposits. **7**

Year of establishing foundation for development of partnerships

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)

Map of Carpathians

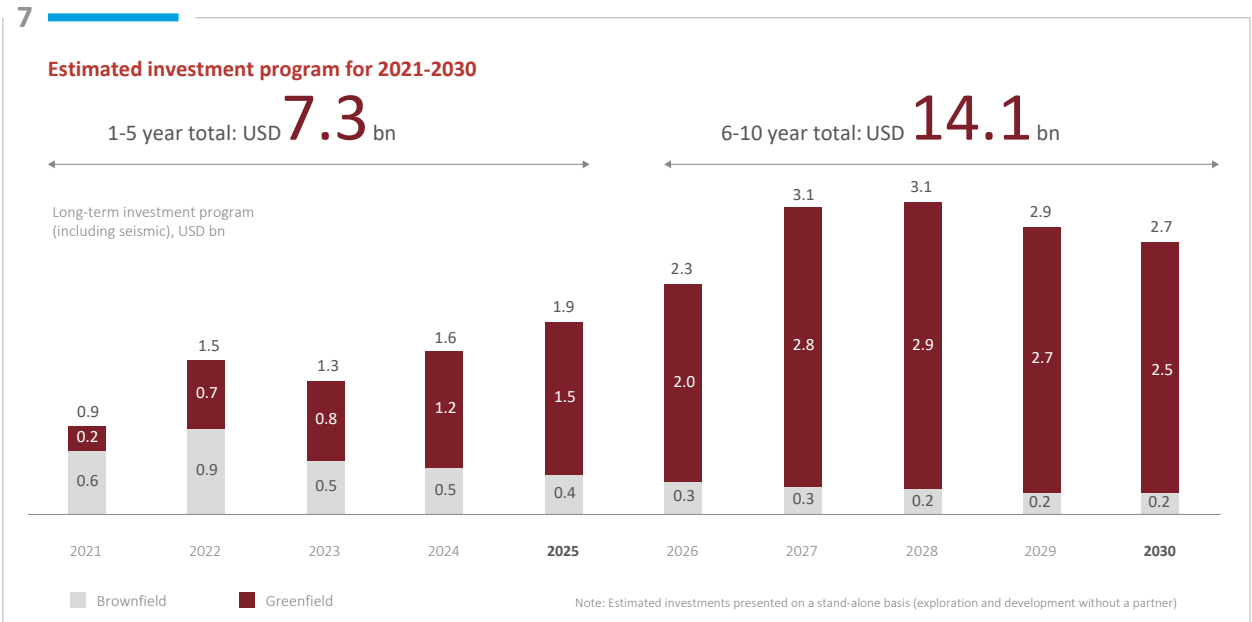


Total licenses: in the process of assessment
Total area: over **7.2** thd sq. km
Regions: Ivano-Frankivsk, Lviv, Chernivtsi, Zakarpattia
Depth: ~ **2.5** km
Type of deposits: conventional collectors
EUR (P50)*: ~ **20-60** bcm
* EUR - estimated ultimate recovery assessed with probability 50% (P50)

served by 147 employees. In general, after concluding the agreement, 42% of hydrocarbon production of GPU Lvivgazvydobuvannya (a branch of JSC Ukrgasvydobuvannya) 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 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 partnership were taken already in 2021:
- (1) In February 2021, Naftogaz Group signed a memorandum of understanding on cooperation with the leading integrated energy company of Southeast Europe, Romania's OMV Petrom. Naftogaz and OMV Petrom aim to implement joint gas exploration and production projects in Ukraine, especially valuable is the experience of OMV Petrom on the Black Sea shelf- the company has discovered the promising Neptune field, has knowledge and technology in offshore drilling, and proven experience of successful and efficient development of onshore sites.
 - (2) In March 2021, Naftogaz Group and the Israeli company Naphtha Israel Petroleum signed a memorandum of understanding on potential geological exploration of hydrocarbons in the Ukrainian part of the Black Sea. Naphtha Israel Petroleum has financial opportunities and confirmed positive experience in the United States and on the Israeli shelf (in the eastern Mediterranean), which may be useful in unlocking the oil and gas potential of the Ukrainian shelf.
 - (3) In March 2021, Naftogaz Group and Polish oil and gas company PGNiG signed memorandum of understanding. The partners jointly aim to combine their experience and resources in developing a number of projects, first of all in Western Ukraine on the border with Poland.

About OMV Petrom

OMV Petrom is the largest integrated energy company in Southeast Europe with an annual hydrocarbon production of 53 million boe in 2020. The group operates processing facilities with capacity of 4.5 million tons per year and high-efficiency power plant with a capacity of 860 MW. The group is represented in the retail market of petroleum products in Romania and neighboring countries by 793 gas stations, as of the end of 2020, under two

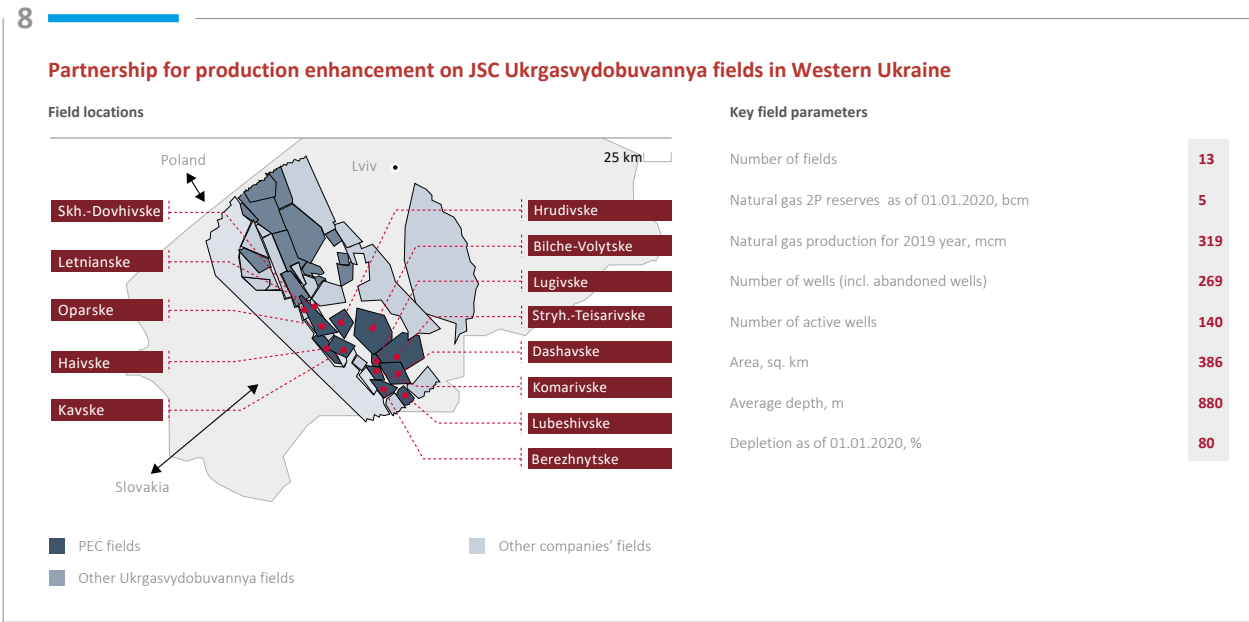
brands – OMV and Petrom. OMV Petrom is a valuable and reputable partner with investment potential, knowledge and relevant experience in the region.

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.

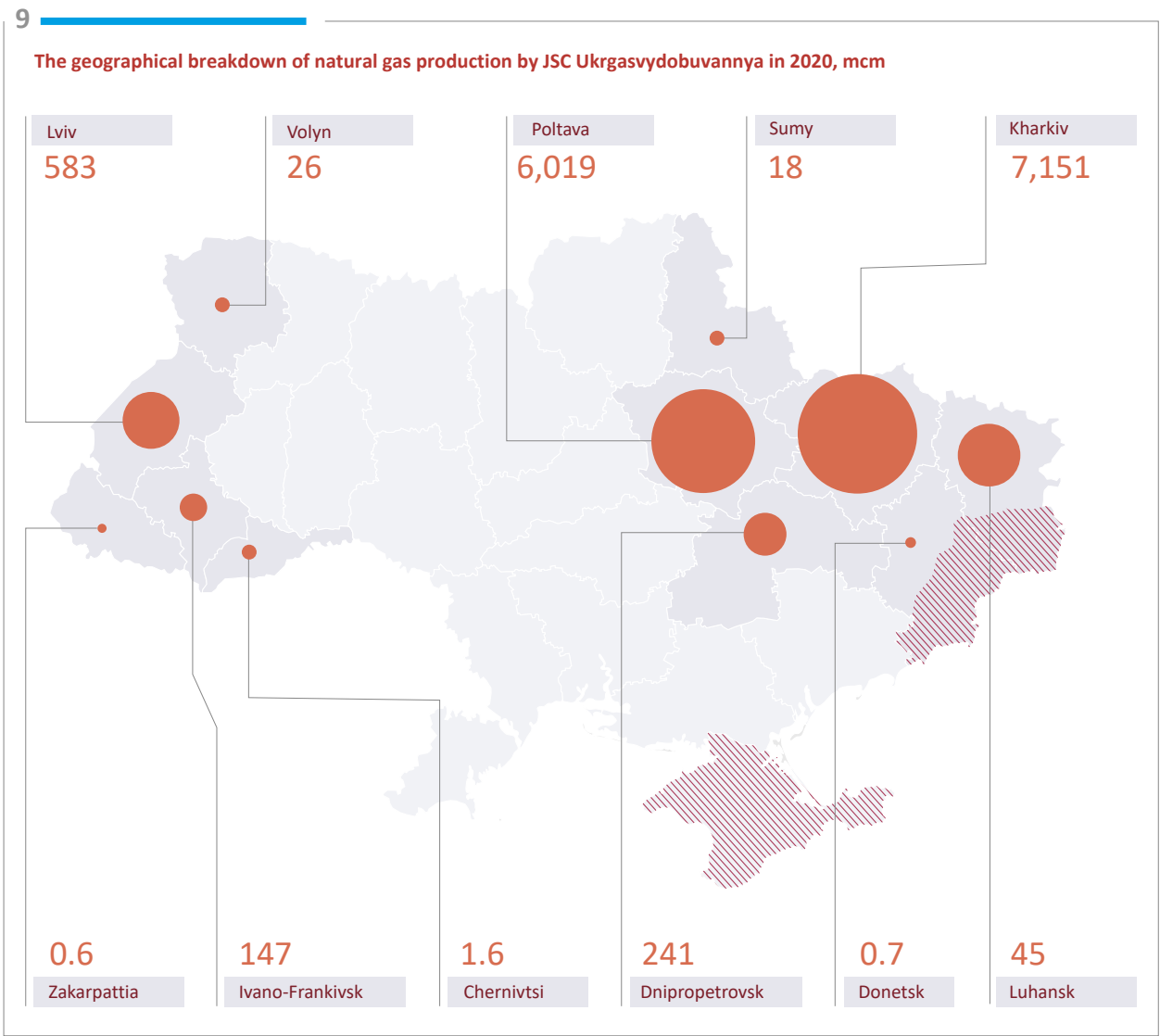
About Polskie Górnictwo Naftowe i Gazownictwo (PGNiG)

PGNiG Group is a leader on the Polish gas market and has 25,000 employees around the world. PGNiG Group is active in exploration and production of oil and gas, international gas trading, sale and distribution of gas and liquid fuel, as well as production of heat and electricity. PGNiG Group comprises over 30 companies, including suppliers of specialized geophysical services, drilling and well maintenance services, which are highly valued in the international market. The Group's holding company, 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.



HYDROCARBON RESERVES AND RESOURCES OF NAFTOGAZ GROUP

	Natural gas, bcm	Oil and gas condensate, mmt	Natural gas (mmbœ)*	Oil and gas condensate (mmbbls)*
NJSC Naftogaz of Ukraine				
proven developed	-	-	-	-
proven undeveloped	-	-	-	-
probable	-	-	-	-
production	-	-	-	-
reserves increase	-	-	-	-
reserves as of 31.12.2020	-	-	-	-
Ukrgasvydobuvannya JSC				
proven developed	168.51	2.77	991.83	24.63
proven undeveloped	27.14	0.25	159.77	2.23
probable	50.38	1.31	296.53	11.01
reserves as of 31.12.2020	246.03	4.32	1,448.13	37.86
Ukrnafta PJSC				
proven developed	9.93	13.67	72.47	99.75
proven undeveloped	5.04	4.90	36.78	35.77
probable	11.38	10.30	83.04	75.19
production	2.06	2.75	15.06	20.05
reserves increase	0.05	0.61	0.39	4.48
reserves as of 31.12.2020	24.33	26.73	177.61	195.15
Assets of Naftogaz Group in AR of Egypt				
proven developed	0.15	0.25	0.88	1.86
proven undeveloped	0.00	0.02	0.01	0.15
probable	0.06	0.16	0.38	1.17
production	0.18	0.22	1.04	1.60
reserves increase	0.15	0.14	0.88	1.04
reserves as of 31.12.2020	0.19	0.36	1.10	2.62
Naftogaz Group				
proven developed	178.59	16.68	1,065.18	126.24
proven undeveloped	32.18	5.17	196.56	38.15
probable	61.82	11.77	379.94	87.37
production	2.24	2.97	16.10	21.65
reserves increase	0.20	0.76	1.26	5.52
reserves as of 31.12.2020	270.55	31.41	1,626.85	235.63

Source:

For Naftogaz: NJSC Naftogaz of Ukraine, PJSC Ukrgasvydobuvannya NJSC Naftogaz of Ukraine Branch in Arab Republic of Egypt Estimated Future Reserves, Resources and Income Attributable to Certain Interests and Derived Through a Concession Agreement Escalated Parameters as of December 31, 2014 by Ryder Scott Company, L.P. In 2017, the State Geologicals and Subsurface Service of Ukraine annulled the special permits for the use of the subsoil and the right of Naftogaz to develop Budyschansko-Chutivska, Obolonska and Pysarivska areas, hence reserves of Naftogaz equal zero as of year-end 2020. Numbers for Naftogaz do not include data for special permits in the Black Sea and the Sea of Azov, control of which was lost due to annexation of the Autonomous Republic of Crimea.

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 «DeGolyer and MacNaughton» company.

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 DeGolyer and MacNaughton. Production data are provided for period from April 1, 2019 to December 31, 2020 and include production volumes of companies with Ukrnafta full or partial ownership that is not reported in Ukrnafta production volume pro rata to Ukrnafta ownership. Hydrocarbon reserves increase data are for year of 2019-2020. Both production and reserves increase data are based on non-PRMS management data.

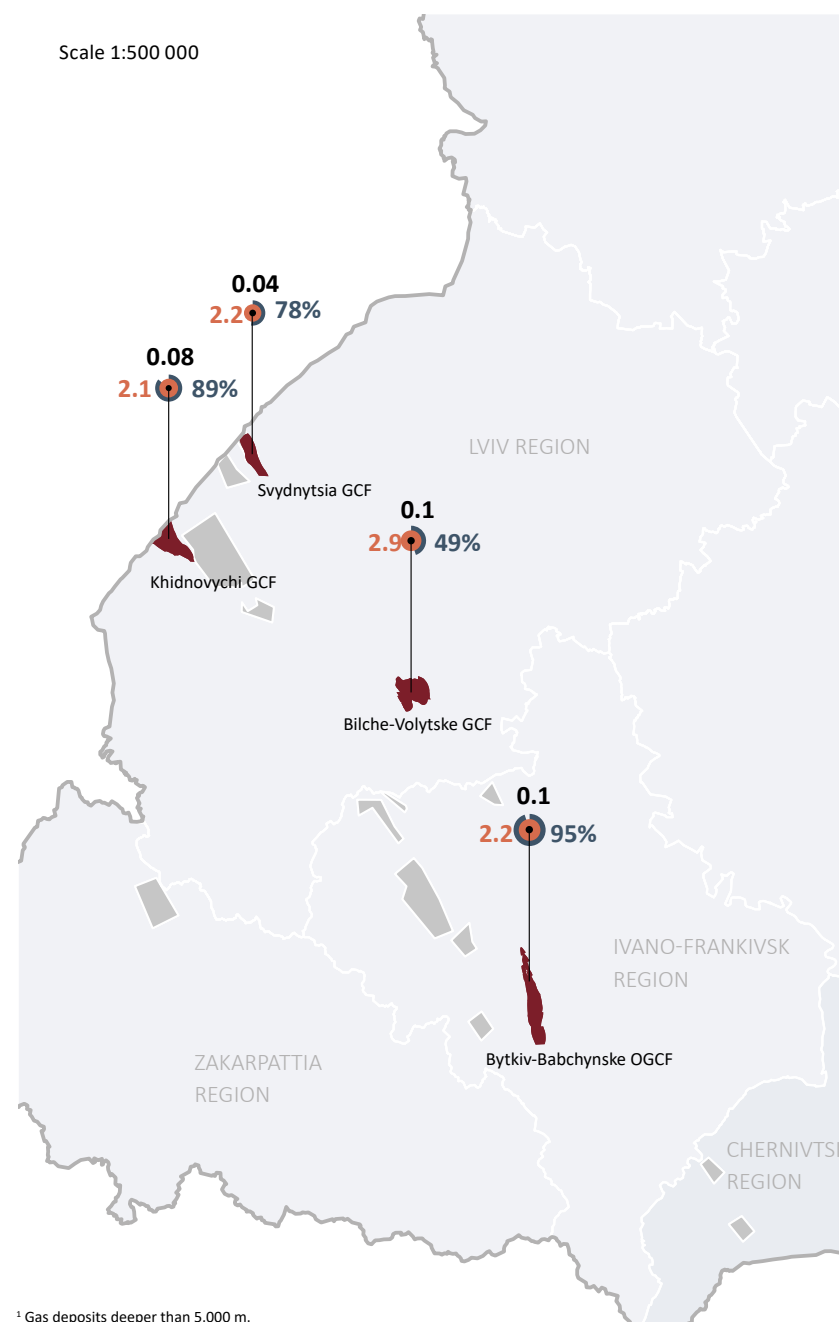
For Naftogaz Group assets in AR of Egypt: NJSC Naftogaz of Ukraine Branch in Arab Republic of Egypt Estimated Future Reserves and Income Attributable to Certain Interests Escalated Parameters as of March 31, 2018 and NJSC Naftogaz of Ukraine Branch in Arab Republic of Egypt Estimated Contingent Resources and Income and Prospective Resources Attributable to Certain Leasehold Interests in the Territory of Alam El-Shawish East Area, in Western Desert in Arab Republic of Egypt Escalated Parameters as of March 31, 2018 by Ryder Scott Company, L.P. Production and reserves increase are provided for the period of April 1, 2018 to December 31, 2020 and are based on non-PRMS management data.

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 volumes from cubic meters into barrels of oil equivalent were identified by auditors according physical properties of hydrocarbon fluids. For Ukrgasvydobuvannya, ratio of 6,000 cubic feet of gas per barrel of oil equivalent is used for conversion purposes. For Ukrnafta, 7.30 ratio is used to convert 1 thousan cubic meters of natural gas or 1 ton of condensate or oil into barrels (of oil equivalent). For Naftogaz Group assets in AR of Egypt, 7.33 ratio is used to do conversion between tons and barrels for oil and condensate. For Naftogaz, 7.28 ratio is used to do conversion between tons and barrels for oil and condensate.

JSC Ukrasvydobuvannya fields that account for more than 2/3 of total production

Western oil and gas region

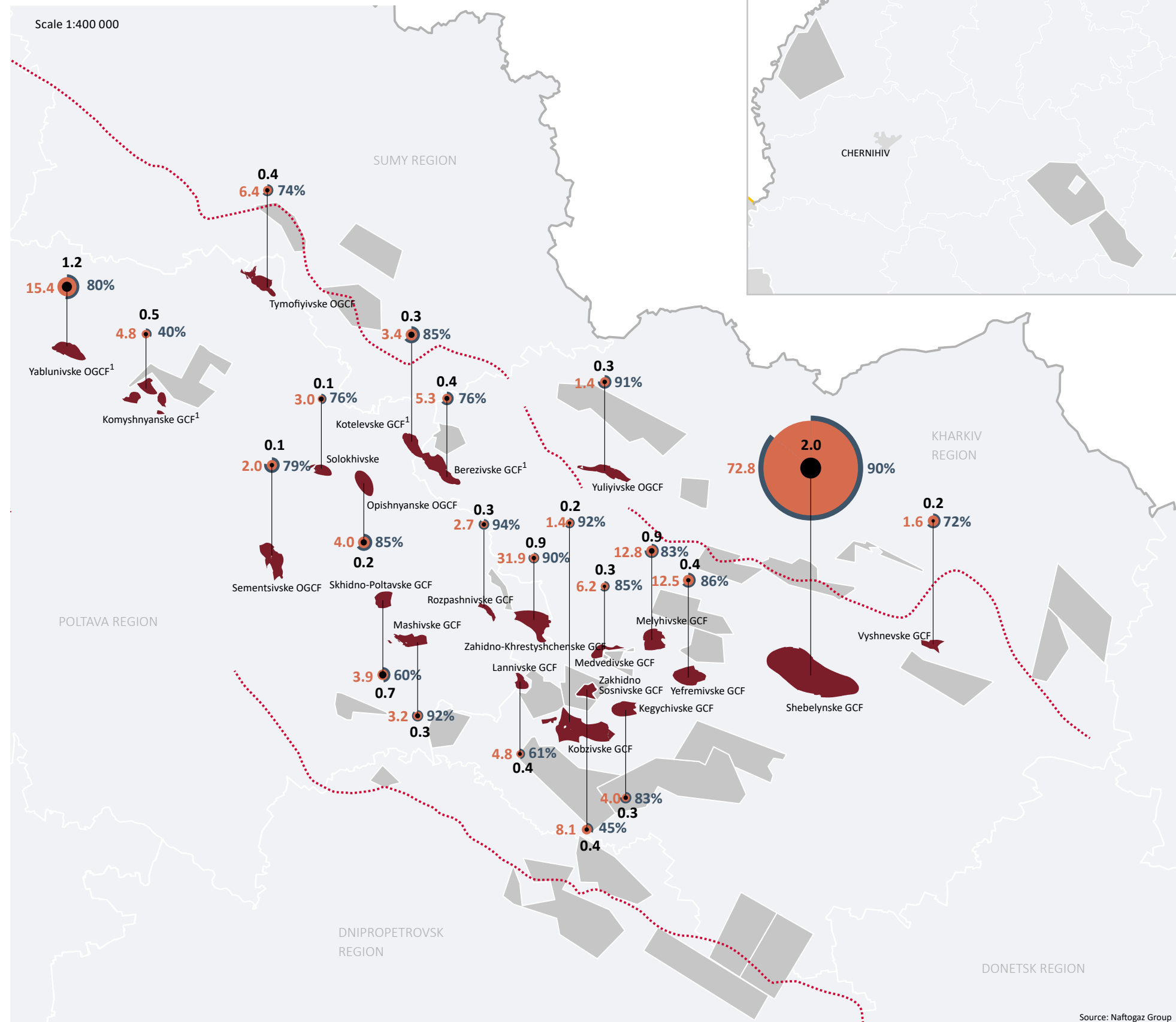
Scale 1:500 000

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

- Production in 2020, bcm
- Remaining reserves as of 31.12.2020², bcm
- % produced to date out of original reserves
- Ukrasvydobuvannya's largest fields
- New exploration permits in 2014-2020
- Borders of Dnieper-Donets basin

Eastern oil and gas region

Scale 1:400 000



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.
- Naftogaz implemented the ETRM system to put its trading and risk management on a qualitatively new level.

Commercial segment sales

5.8 BCM

grew almost twofold from 3.0 bcm in 2019 to 5.8 bcm in 2020

+2%

Naftogaz market share in the commercial segment increased from 28% in 2019 to 30% in 2020

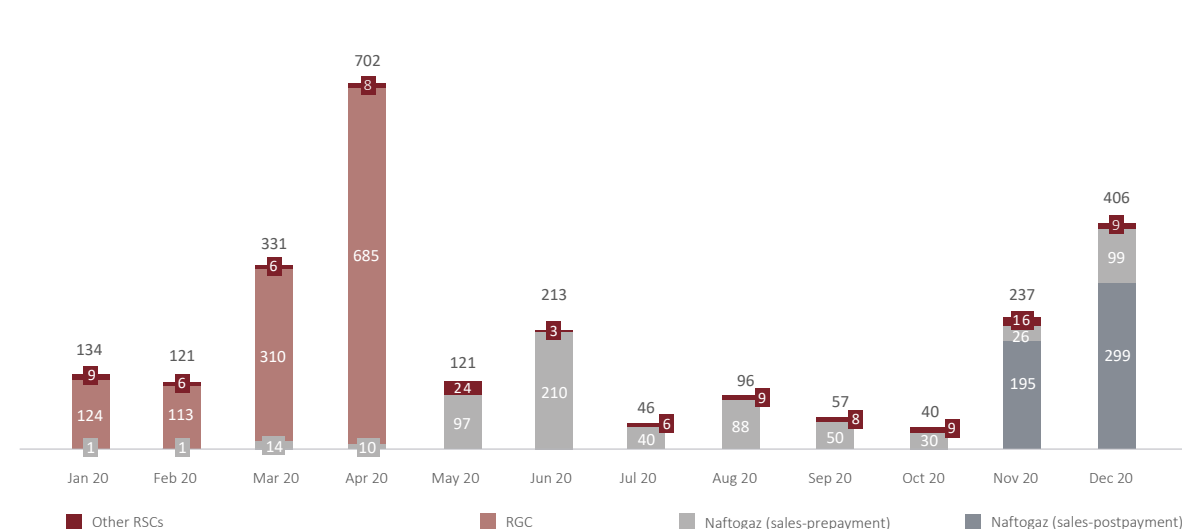
2020 was a year of significant progress in natural gas market liberalization. This started with the introduction of market pricing for household and district heating company supply from 1 January, 2020, and was followed by the abolition of PSO in the retail segment. Coupled with Ukraine’s further integration 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

1

2020 UEEX volume traded dynamics and structure, mcm



Source: Naftogaz Group, UEEX

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 ninefold from 123 mcm in 2019 to 1,160 mcm in 2020. This was done 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

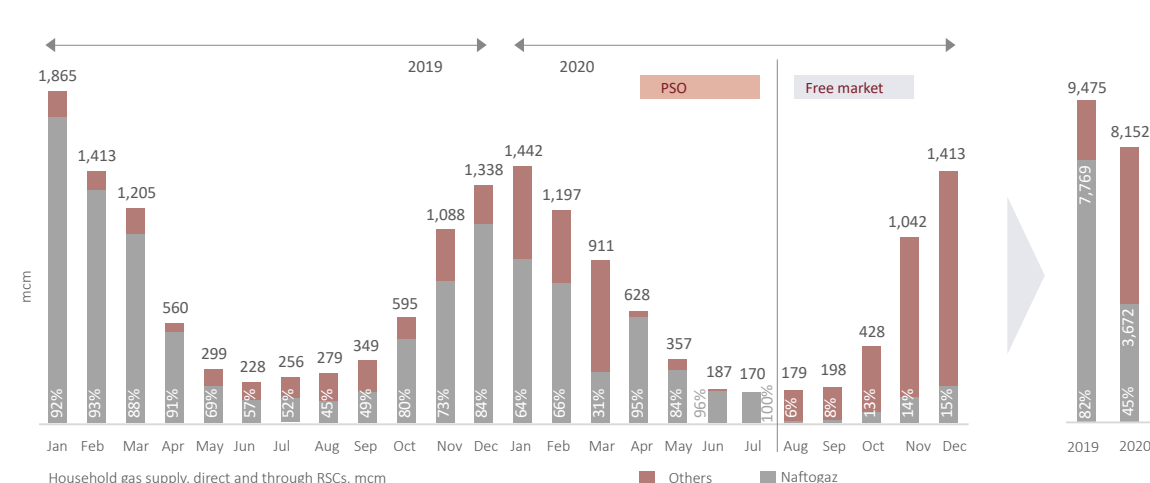
Volumes sold through UEEX

1 160 MCM

Naftogaz trading volumes at UEEX in 2020

2

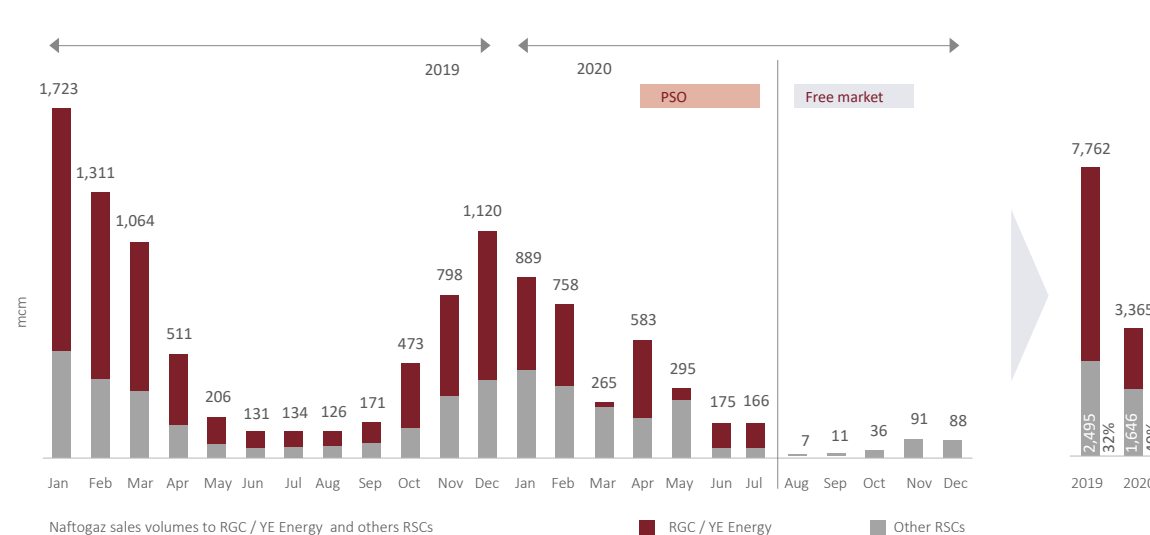
Naftogaz volume and share of RSC gas supply portfolio in 2019-2020



Source: Naftogaz Group

3

RGC / YE Energy vs. other RSCs share in Naftogaz RSC sales in 2019-2020



Source: Naftogaz Group

TSO auctions

80 %

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

Supplies to TSO

3.6 BCM

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.

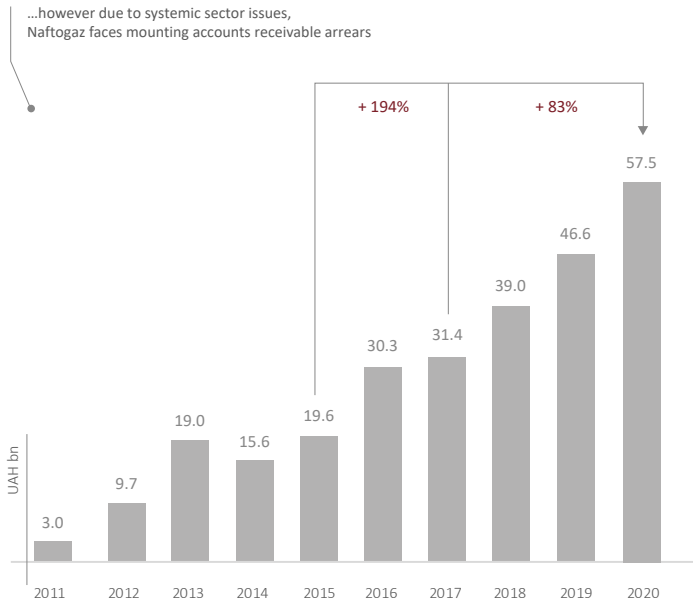
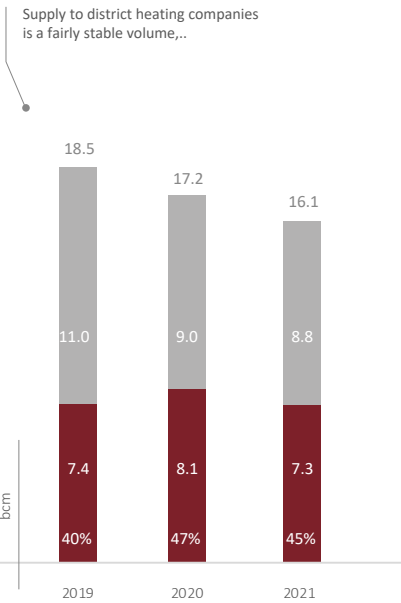
Furthermore, in 2020, Naftogaz Trading has significantly increased its sales to the direct industry segment with sales rising by 280 mcm, contributing to the growth of market share to industrial segment (excluding TSO of Ukraine) to 5%. Similar to the UEEX trading ramp-up, this result was possible due 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.

4

Naftogaz volume and share of DHC gas supply portfolio in 2019-2020



Naftogaz Group natural gas sales and supply

■ DHC segment ■ Other segments

DHC accounts receivables gross balance (end of period)

Source: Naftogaz Group

5

Naftogaz Group trading controls framework



NAFTOGAZ GROUP
TRADING CONTROLS FRAMEWORK



Counterparty risk management

- Counterparty risk is managed by setting the limits and controlling the exposure
- Security, Compliance and Finance ensure counterparty eligibility
- Risk Committee approves counterparty limits methodology and reviews bespoke / exceptions cases



Price risk management

Price risk is managed by Red Lines for traders, open position limit, price forecasting, hedging strategies development and implementation



Mandates

Mandates for traders represent their authority for concluding deals (make the appropriate decision and sign the individual contract prepared by Back Office)

Source: Naftogaz Group

While many RSCs stopped purchasing gas from Naftogaz following PSO abolition, most of the registered gas sales decrease resulted from RGC 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 it 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 controls 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.

5 %

Naftogaz Trading’s share in the industrial market segment (excluding TSO of Ukraine)

Natural Gas Storage Division

KEY RESULTS IN 2020

- 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 (2% less than the previous year).
- 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.
- 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.
- Net revenue of the Natural Gas Storage segment in 2020 was UAH 5.1 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.
- EBITDA of the Natural Gas Storage segment in 2020 was approximately UAH 3.3 billion, which is 67% higher than the previous year.
- 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 headquarter and production structural units. The Natural Gas Storage Division includes 12 UGS facilities in mainland Ukraine, taking into account the Verhunske UGS that, as of 2020 year-end, was in the part of Luhansk region that is temporarily occupied territory of Ukraine.

After the unbundling 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. **1**

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. **3**

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. **2**

- 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 rebooted, 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.

Production activities

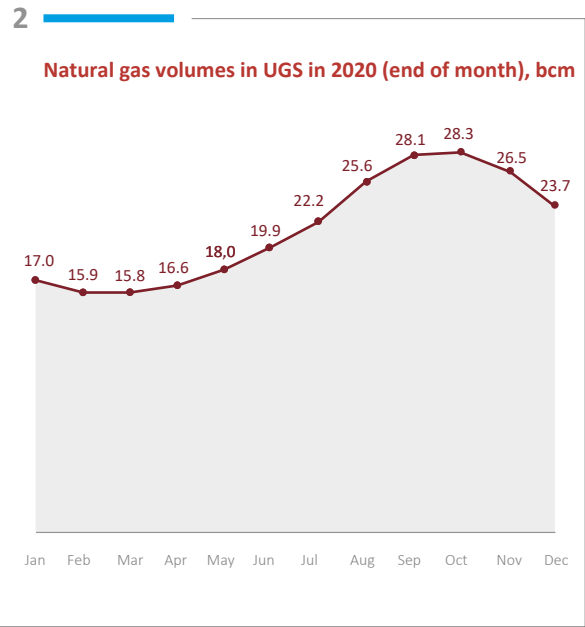
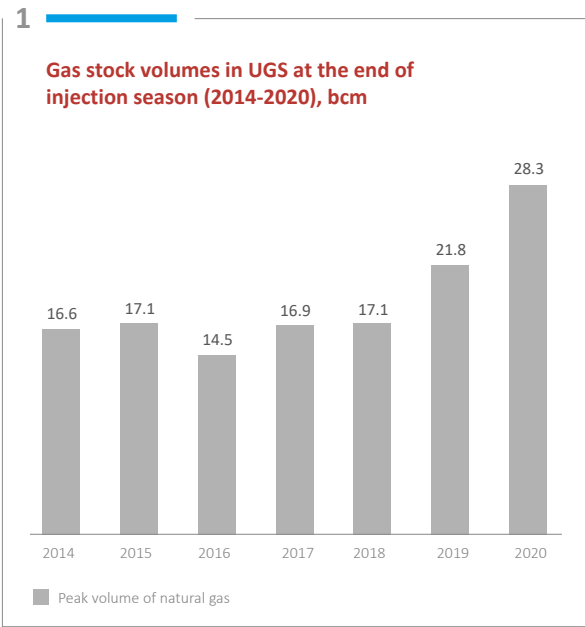
During 2020, a series of important production activities were implemented that significantly improved the technical status of major equipment and increased the reliability of UGS operations. 62 wells in underground storage facilities were repaired and well servicing provided for 99 wells. 61 maintenance works and 20 repairs of UGS gas pumping units were carried out. During neutral periods (following the 2020 withdrawal and injection seasons), planned repair and maintenance work of technological equipment and geological control of deposits were implemented in full.

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.

- 1) The first stage opens the possibility for participants of the gas market of Ukraine to conduct trade operations with customs-cleared natural gas stored in gas storage facilities through the platform of the Ukrainian Energy Exchange. At this stage, resident companies working with customs-cleared 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.



* excluding Verhunske UGS located on temporarily occupied territory of Ukraine (Luhansk region)

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. These 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 (total) tariff for the next season remained at almost the same level as the previous year, increasing demand for UGS services.

The Natural Gas Storage Division plans to continue cooperation with the NEURC in order to improve the tariff methodology for natural gas storage services and based on common practices of European operators. 4

IMPROVING EFFICIENCY AND MODERNISATION OF TECHNICAL FACILITIES

On 24 June 2020, the NEURC approved the 2020-2029 Gas Storage Development Plan for SSO of Ukrtransgaz, including the 2020 investment program of UGS facilities of Ukraine.

The total amount of investments in UGS infrastructure for 2020-2029 is approved at UAH 13.5 billion (excluding VAT).

The first major project, which was launched following the approval of program, was the reconstruction of gas dehydration unit

with technological process automation at Dashavske UGS.

The cost of reconstruction amounted to UAH 182 million (excluding VAT).

Automation of the technological process of gas dehydration unit installation, which is part of the project, will allow to control online the quality parameters of the gas transmitted by the main gas pipelines.

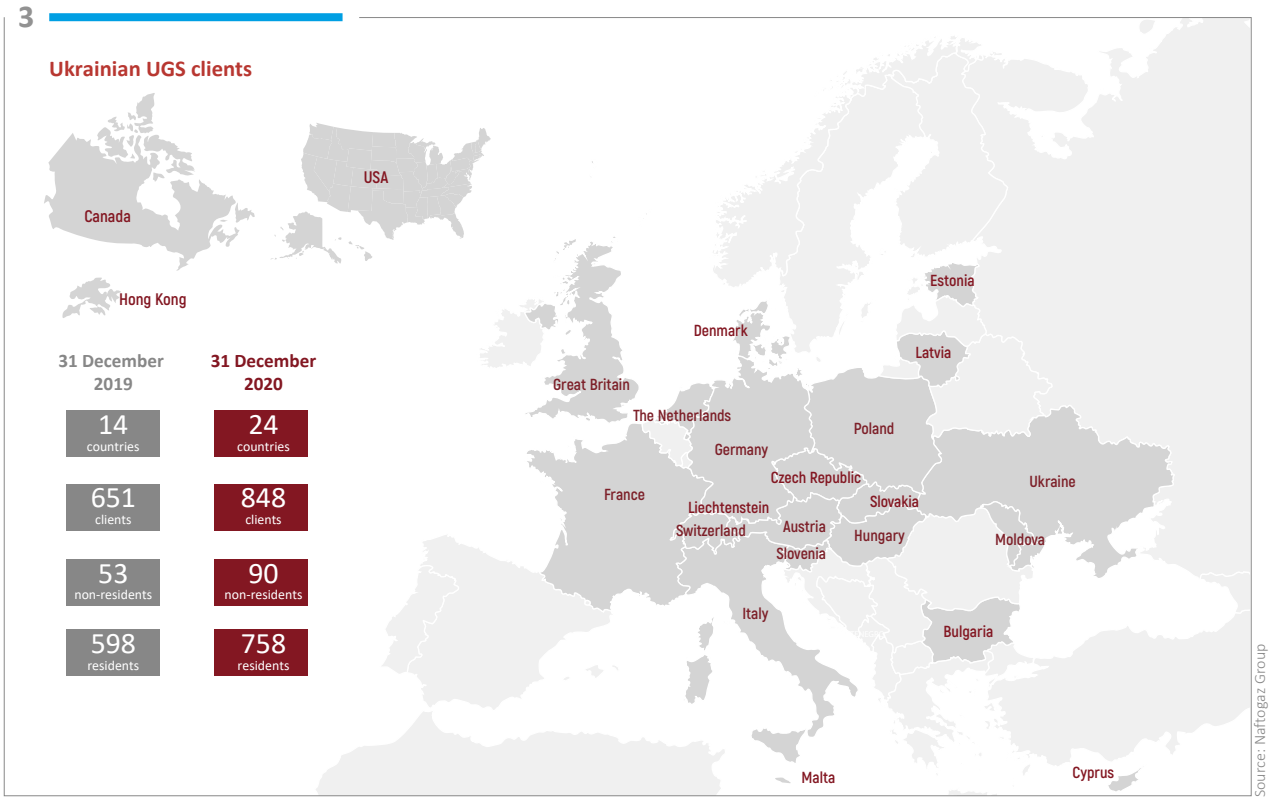
Re-equipment of the gas dehydration unit will result in reduction of the annual fuel gas consumption by 55-65%. In addition, modernisation of the technical equipment will mitigate the negative environmental impact.

Other 2020 key investment projects were the following: reconstruction of gas-collecting station at Bohorodchany UGS (UAH 239 million), reconstruction of gas-collecting station plot at Chervonopartyzanske UGS (UAH 108 million) and implementation of construction facilities for early emergencies detection at Oparske and Bilche-Volytsko-Uherske UGS facilities (UAH 8.2 million). 5

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 analyse 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.

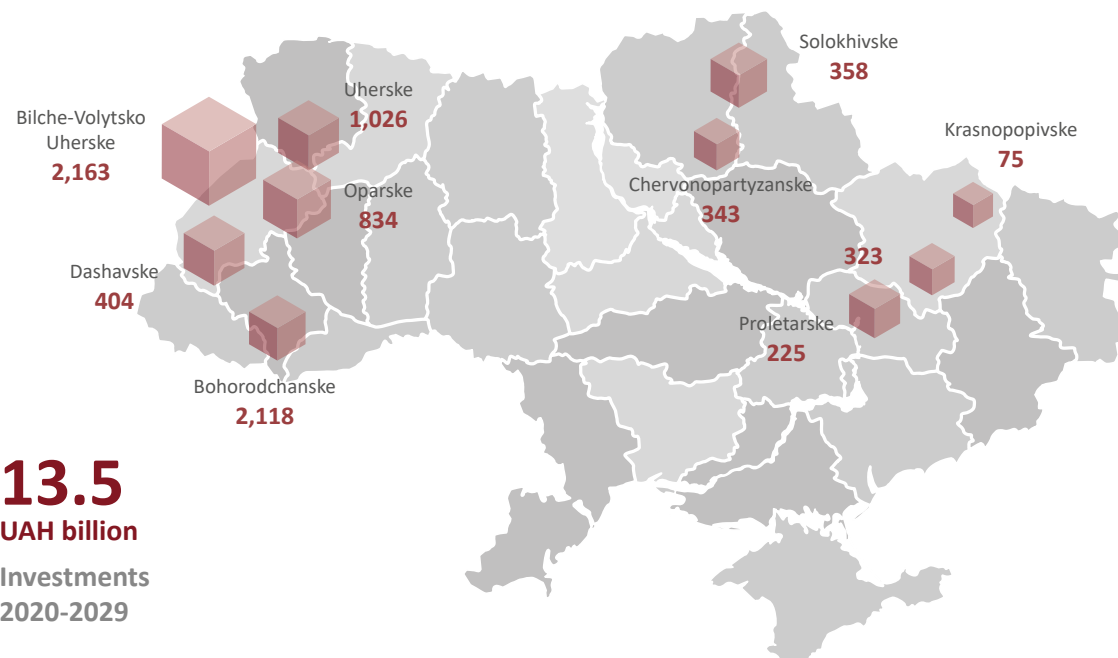
Once this software package enters commercial operation, Ukrainian gas storage facilities will be ready for the next stage of integration with the EU gas market, i.e. interconversion



5

UGS development plan for 2020-2029, UAH million

According to NEURC Resolution №1151 of 24.06.2020 (amended)



13.5
UAH billion
Investments
2020-2029

6

IT-platform functionality

Register/database

- Customer registers for gas storage services and natural gas storage contracts
- PCD Register (periodic customs declarations) Synchronization with information platform of Gas TSO of Ukraine
- Downloading of gas residues on customer accounts
- Generation of notifications as per Gas Storage Network Code

Nomination

- Nominations/renominations
- Physical flow scheduling (data management for verification “matching” for GTS points)
- Trade notifications
- Verification of nominations/renominations with “Customs Warehouse” and “short haul” modes and the residual amount as per PCD

Allocation

- Obtaining actual data of gas injection/ withdrawal volumes in/from underground storage facilities
- Downloading physical data on injection in/ withdrawal from UGS
- Change of allocation based on the results of nominations/CU (Customs Union) verification
- Verification of trade notifications with “Customs Warehouse” and “Customs Warehouse short haul” modes

Customs Warehouse

- Maintenance of additional CD (customs declarations)
- Customer warehouse clearance
- Capacity with limited “short hauls” in “Customs Warehouse” regime
- Records of gas with “Customs Warehouse” and “short haul” types by consignments
- Change (creation/division) of consignments (notifications with “Customs Warehouse” and “short haul” modes)
- Gas metering injection/withdrawal in “Customs Warehouse” mode

Storage System Operator account

- Capacity allocation
- Records of arrests, 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 a day ahead
- Physical Gas Balance Project
- Free capacity verification

Customer account

- Creation of RFP (Requests for Proposals) to switch over from storage regime with "Customs Warehouse" and "short haul" types to storage regime "main warehouse" or "Customs Warehouse"
- Capacity booking
- Change of volumes of security gas stock
- Change in capacity with limitations
- Capacity booking and allocation
- Carryover pre-payments between services
- Introduction of a new exchange-based product

General

- Creating platform user profiles
- Integration with existing ERP to obtain service payment status, contract synchronization of contracts, debtors, application for the transfer of pre-payments
- IT-platform communication tools
- Brief reports
- Translation of the customer's account
- Display of spare capacity, capacity allocation, gas transfer-trade notifications



Heat Energy Business Division

KEY OPERATING RESULTS OF HEAT ENERGY BUSINESS DIVISION

- Net revenue¹ of Heat Energy Business Division in 2020 amounted to UAH 137.2 million.
- Heat production² in 2020 reached 163.2 thousand Gcal.
- Useful heat output³ reached 99.2 thousand Gcal.
- Electricity generation⁴ in 2020 amounted to 12.0 thousand MWh.
- Over the period of September-December 2020, total volume of provided electricity distribution services⁵ reached 35.6 thousand MWh.
- The business division's 2020 EBITDA was UAH (- 136) million, which is caused by significant losses of heat energy in the network during transmission to consumers, and the regulated tariffs for heat energy supply economically unjustified.
- Automated system of commercial electricity metering (hereinafter also ASCEM) was implemented at CHP Novoyavorivsk and CHP Novyi Rozdil, as well as at distribution system operators.
- The level of payment for natural gas used for heat energy production has exceeded 90% (since the beginning of activity on November 25, 2019).
- Technical documentation destroyed by former asset owners (certificates for boilers and other equipment, calculations of standard characteristics etc.) was restored.
- Consumer base for heat energy and hot water supply in cities of Novoyavorivsk and Novyi Rozdil with a total number of 18.9 thousand subscribers was restored.

CONDITIONS OF ENTRY THE BUSINESS

To address a threat of man-made emergency situation in the cities of Novoyavorivsk and Novyi Rozdil in Lviv region, Naftogaz Teplo LLC was appointed the manager of seized by the state following a criminal investigation CHP Novoyavorivsk and CHP Novyi Rozdil in November 2019. This has been done to secure the start of the heating season and preserve vital infrastructure of these cities. In February 2020, the property involved in the power distribution of electricity in the cities and suburbs of Novoyavorivsk and Novyi Rozdil was also transferred to the management of Naftogaz Teplo. Under the management of Naftogaz Group, both CHPs successfully passed the heating seasons of 2019-2020 and 2020-2021 in Novoyavorivsk and Novyi Rozdil, with population of almost 60 thousand people.

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 Novyi Rozdil is the power supply source that contributes to covering the heat and electricity consumption of Novyi Rozdil. Installed heat generation capacity amounts to 149 Gcal/hour, installed power generation capacity – 52 MW. Natural gas is the main fuel type.

Key performance results of Novyi Rozdil CHP in 2020:

- heat production – 103 thousand Gcal;

- useful heat output – 55 thousand Gcal;
 - electricity generation – 0.7 thousand MWh.
- Due to poor condition of heating networks and their insulation, heat energy losses amounted to 47% in 2020.
- In preparation to heating season 2020-2021, the following works were completed at CHP Novyi Rozdil:
- commissioning works of relay protection systems;
 - verification of commercial and distribution metering devices;
 - certificates for energy generating equipment were produced/restored;
 - implementation of ASCEM;
 - electric cables were restored after thefts/sabotage;
 - partial routine maintenance for main and distribution heating networks was completed;
 - equipment output performance standards were developed, calculations for standard specific consumption of fuel for heat and electricity generation by the CHP during cogeneration were completed.

CHP Novoyavorivsk is the power supply source that contributes to covering the heat and electricity consumption of Novoyavorivsk. Installed heat generation capacity amounted to 77 Gcal/hour, installed power generation capacity – 50 MW. Natural gas is the main fuel type.

- Key performance results of CHP Novoyavorivsk in 2020:
- heat production – 60 thousand Gcal;
 - useful heat output – 44 thousand Gcal;
 - electricity generation – 11.3 thousand MWh.
- In preparation for the heating season 2020-2021, the following works were completed:

- 110 kV and 6 kV electricity supply equipment were inspected;
- electrical equipment was repaired, which allowed to ensure trouble-free production of electricity in the heating season 2020-2021;
- equipment output performance standards were developed, calculations for standard specific consumption of fuel for heat and electricity generation by the CHP during cogeneration were completed;
- certificates for energy generating equipment were restored;
- routine maintenance for two boilers was completed, turbine generator No.1 was repaired;
- prepared for implementation and implemented ASCEM.

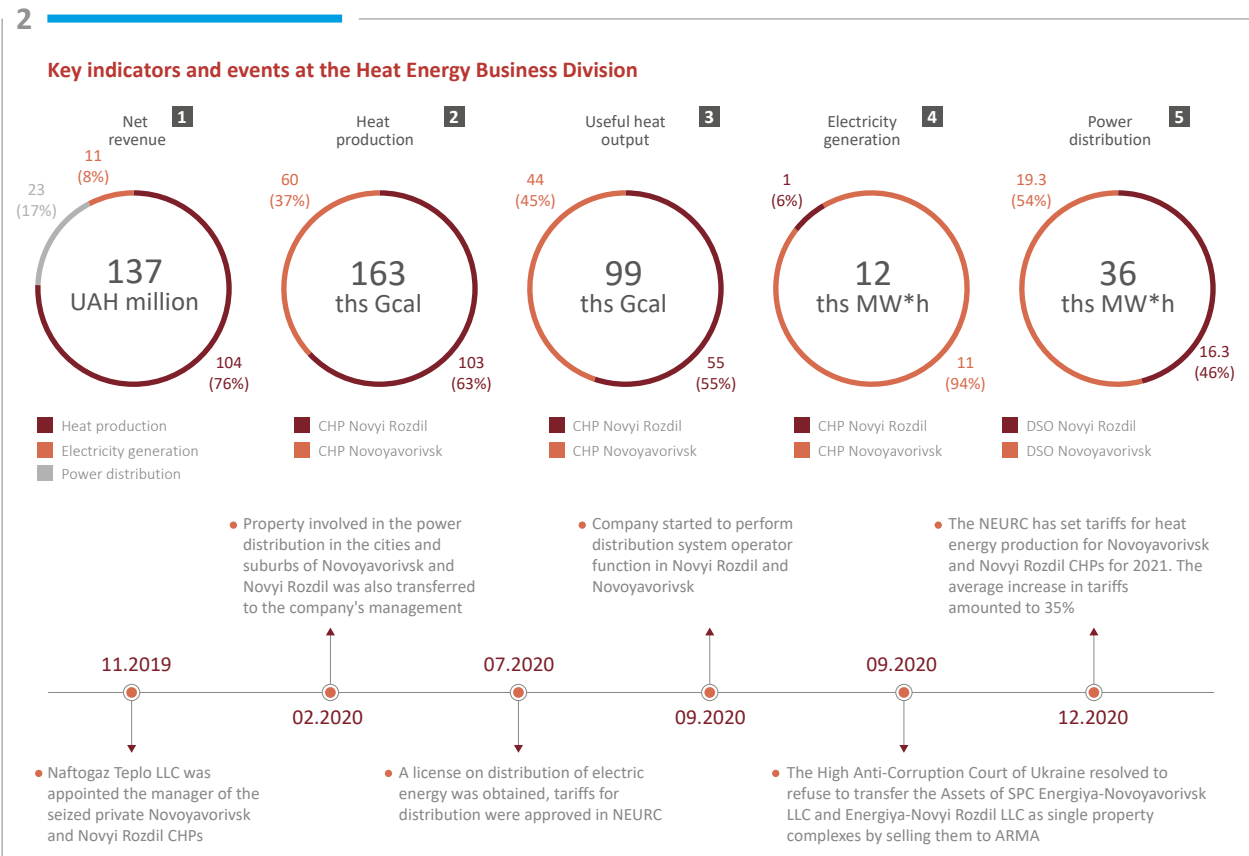
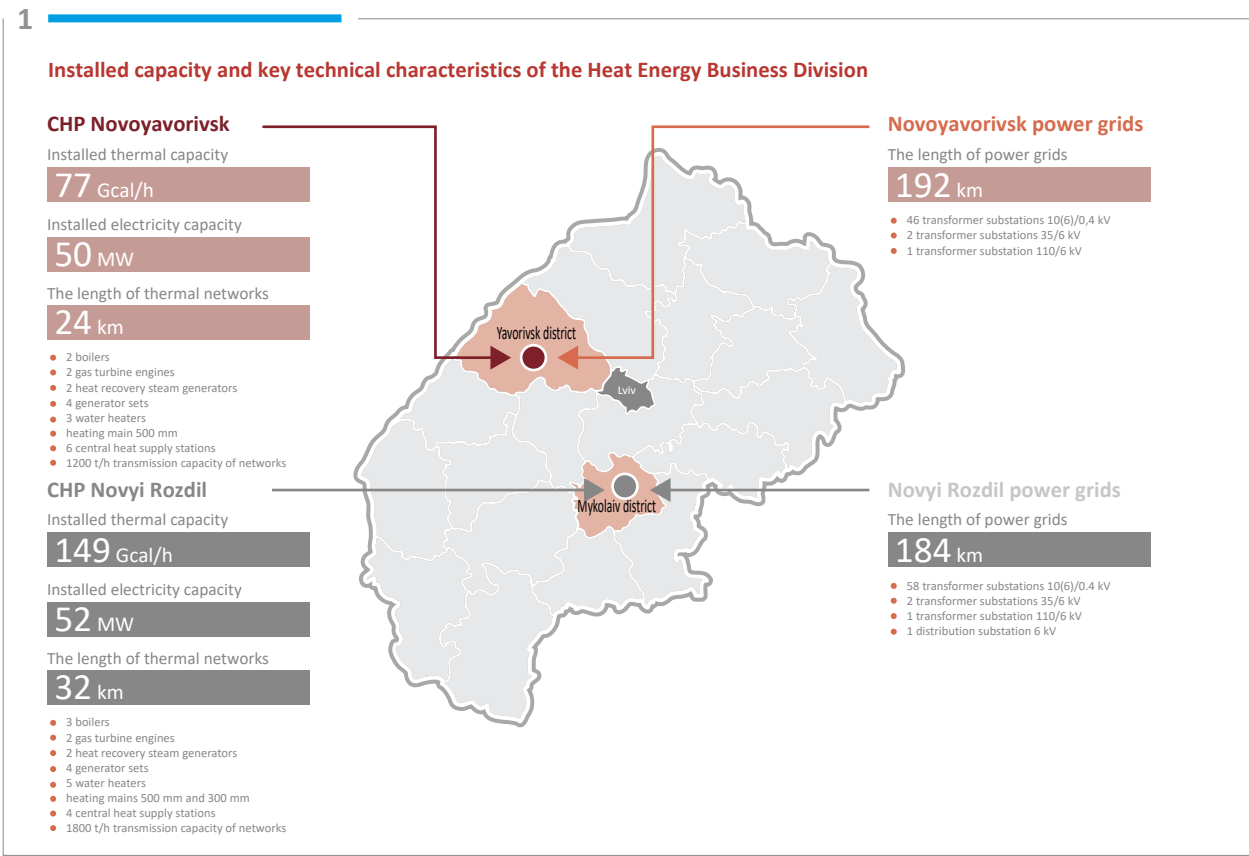
Distribution system operators

For the purpose of power distribution, only the grids transferred to the Company in accordance with management agreements and acts of acceptance and transfer of Assets dated February 17, 2020 are operated: Novoyavorivsk power grids, 192 km of length and Novyi Rozdil power grids, 184 km of total length.

Key performance results of distribution system operators (hereinafter also DSO) in 2020:

- 16.3 thousand MWh distributed by DSO Novyi Rozdil;
- 19.3 thousand MWh distributed by DSO Novoyavorivsk.

In July 2020, Naftogaz Teplo obtained a licence for the power distribution business, approved its electricity distribution tariffs, and started to perform distribution system operator function in Novyi Rozdil and Novoyavorivsk in September. Naftogaz Teplo initiated amendments that were made to the methodology for calculation of the grid



connection fee, which made it possible to set the connecting capacity fees for 2021 on the average level in Ukraine. ASCEM for distribution system operators was implemented in 2020.

PERSPECTIVE PLANS FOR TECHNOLOGICAL DEVELOPMENT OF HEAT ENERGY BUSINESS DIVISION

Improved reliability in operation of Novyi Rozdil and Novoyavorivsk CHPs, as well as reduction of expenditures/ losses of technological resources require a range of actions and measures:

CHP Novyi Rozdil

- repair steam boiler No.5;
- repair turbine generator No.2;
- upgrade pumping equipment;
- upgrade of electrical equipment of the station;
- repair pressure reducing station for natural gas;
- repair chemical water treatment equipment;
- repair main and distribution heating networks.

CHP Novoyavorivsk

- repair boilers;
- upgrade automated energy process control systems for boilers;
- repair backpressure turbine;
- perform reconstruction of condensate machine;
- replace two of three DWHs (district water heaters) which are in an emergency condition;
- upgrade pumping equipment;
- repair equipment for chemical treatment of process water;
- upgrade electrical equipment.

Distribution system operators

110-0.4 kV substations and networks were put into operation in the 1950s-1960s. The equipment is obsolete and worn-out, its condition causes a significant increase in electric energy losses in the distribution system and technological malfunctions.

Accident-free and effective network operation requires a range of actions and measures:

- replace switching equipment;
- implement up-to-date protection systems;
- renew the transformer fleet;
- replace induction meters of electrical energy of accuracy class 2.0 (more than 50% of all meters) with metering devices of accuracy class 1.0.

The scope of financing repair and investment programs is limited by the amounts approved in the power distribution tariff structure, and are considerably lower than the scope of capital investments required.

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 activities 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 Energiya-Novoyavorivsk LLC and Energiya-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 Energiya-Novoyavorivsk LLC and Energiya-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 favour of the claimant and the management agreements are terminated, there is a threat to Naftogaz Group’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 supply 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.

MAIN AREAS OF FURTHER DEVELOPMENT FOR THE BUSINESS DIVISION

Development of consumer services

The business division is planning to introduce a series of initiatives: extend the functionality of the consumption metering system, create personal consumer profiles, develop a mobile application, introduce electronic administration and billing system.

Saving on fuel gas

The investment plan of the Heat Energy Business Division for 2021-2025 includes funds for two projects: upgrade of heat machinery equipment and reconstruction of heating networks. Implementation of these projects would enable a 35% reduction in natural gas consumption by 2025.

Development of flexible generation

Intensive integration of RES in Ukraine demands significantly greater flexibility in energy systems that may be achieved through high-manoeuverable generation. Such capacities are already in deficit in Ukraine. Global experience regulating electricity producers demonstrates that gas turbine plants are one of the most efficient formats that meet the equipment requirements in terms of speed of load acceptance. This is the exact kind of generation managed by Heat Energy Business Division which analyzed for development prospects.

Review of options is currently ongoing to restore sustainable operation of automated process control systems at gas turbine plants. Options are considered for sourcing of high-skilled personnel to operate the equipment, as well as a trial run of plants aimed at identifying the most optimum and cost-effective operation modes.

Implementation of fuel gas saving and flexible generation development initiatives is possible only if the ownership of Assets of SPC Energiya-Novoyavorivsk LLC and Energiya-Novyi Rozdil LLC and main and distribution heating networks is transferred to Naftogaz Teplo.

CHP Novyi Rozdil

Key performance results of Novyi Rozdil CHP in 2020

103 thousand Gcal
heat production

55 thousand Gcal
useful heat output

DSO Novyi Rozdil

16.3 thousand MWh
distributed by DSO Novyi Rozdil

CHP Novoyavorivsk

Key performance results of CHP Novoyavorivsk in 2020

60 thousand Gcal
heat production

44 thousand Gcal
useful heat output

11.3 thousand MWh
electricity generation

DSO Novoyavorivsk

19.3 thousand MWh
distributed by DSO Novoyavorivsk

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 oil solutions, artificial lift, new technologies with coiled tubing units, hydro 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 living trailers 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 supportive 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 competencies 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 competencies 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 (№35 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 Ukrburgaz, the service drilling branch of Ukrgasvydobuvannya, during 2020 has created additional reserves for further overheads savings.

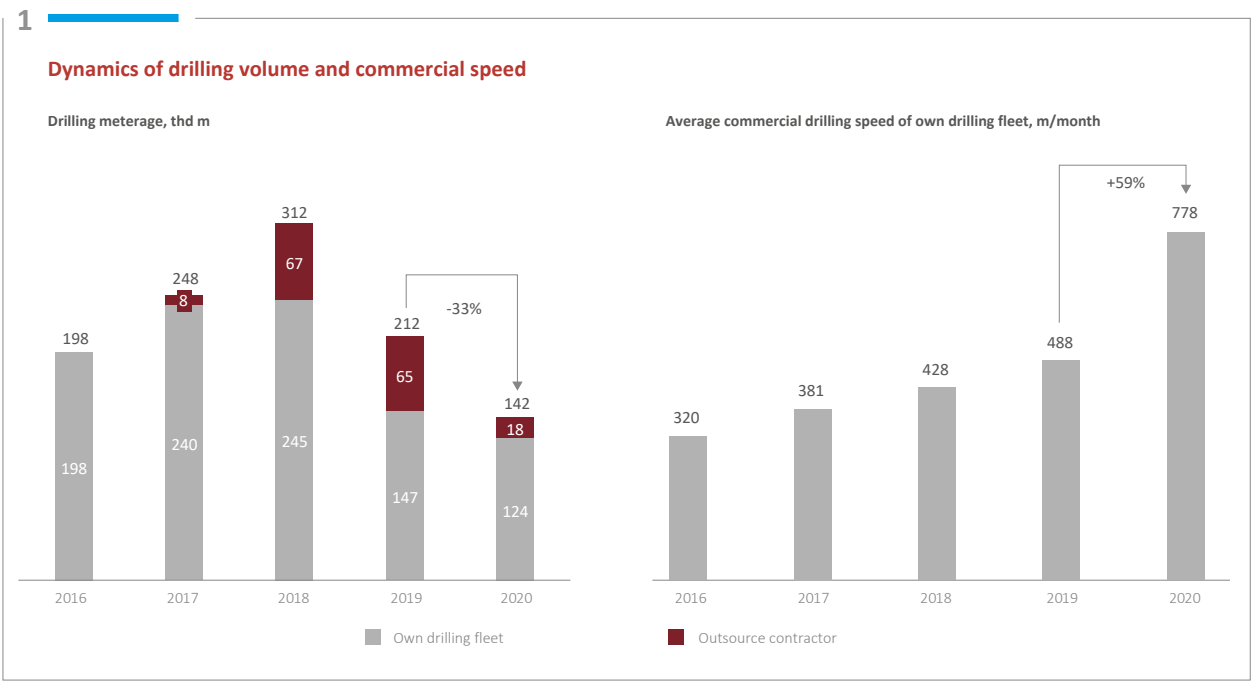
- In 2020, the Technical division team continued implementation of new technologies and projects that are unique for Ukrainian oil and gas industry including:
- started drilling well №12 at Svyatogirskoe tight gas field with a depth of 5,335 meters;
 - finalized drilling well №888 at Shebelynske field with a depth of 5,765 meters using the own’s Honghua drilling rig in partnership with LLC Schlumberger Ukraine (subsidiary of Schlumberger Limited, the USA);
 - introduction of controlled pressure drilling technology (first time in Ukraine);
 - directional well №109 at Tymofivske 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 preventative 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).

- A significant event for the division is completion of fishing works at one of the deepest wells of the Naftogaz Group, №29 at Komyshnyanske 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 preventors, 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 of 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 Ukrgasvydobuvannya JSC, in partnership with LLC Weatherford Ukraine, drill pipe 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 Ukrgasvydobuvannya JSC;



New well workover rig

- Wellbore Interventions and Fishing training and certification performed for 20 workers. Over 100 workers are set to be certified in 2021;
- standard for transporting equipment and placing it on the well to reduce non-productive time of crews was developed for new workover rigs.

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:

- nitrided hydro-sandblasting perforation on coiled tubing in a well with reduced formation pressure;
- 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 №37 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 №15 at Pivdenno-Grabynske field reached 12 thousand cubic meters, which is quite substantial for wells in Lviv 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 – Tacrom 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 fracturing was performed by the division's fleet at deep wells in Poltava region (2 hydro fracturing operations on the wells of Skhidno-Poltavske 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, 2,216 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:

- GoWell equipment to conduct logging in open wellbore, ensuring the possibility of operations at temperatures of 175°C and pressure of 1,360 ATM, 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 preventors.

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

plunger system was installed (well №8 at Valyukhivske field), a piston system that is installed inside the tubing and mechanically prevents the formation of plugs 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 25% (7.5 thousand cubic meters of gas and 3.4 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 warehouses, 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, significant 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 system began.



Svyatogirsk field surface infrastructure complex



Chervonodonetsk BCS reconstruction

Transport, logistics and special equipment fleet management

In 2020, a program to optimize the management of transport, logistics, and the special equipment fleet, which will focus on transition to centralized management, scheduling, and

Rebooting capital projects management competence

2020 became the year of reformatting of 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;

standardization of processes, was launched. This should help reducing the costs for vehicles and special equipment by up to 10% in 2021.

- 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 Ukgazspetsbudmontazh) 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 has reduced the time spent connecting the well by 20%, which makes it possible to start operating wells in the shortest possible time.

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-Sloviyansk.

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 Ukgasvydobuvannya 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 (pilot project)

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, modeling operations, and provide ample opportunities for collaboration between the designer, contractor and customer.

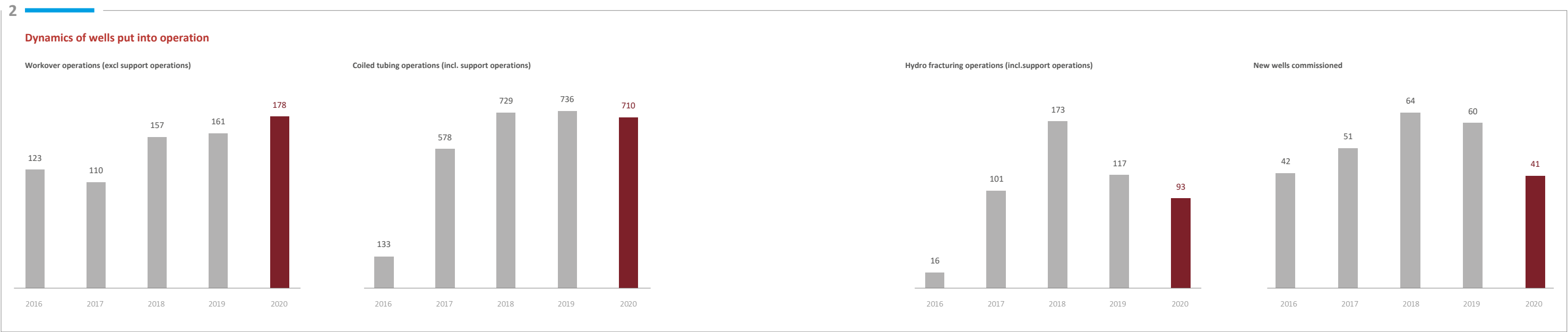
Also in 2020, major infrastructure projects were implemented with a planned commissioning date in 2021-2022. These included reconstruction of Chervonodonetsk BCS, Yablunivka BCS, Khrestyshchenska BCS, etc. During the implementation of Chervonodonetsk and Yablunivka BCSs reconstruction projects, equipment was used in a block design, which saved time, labor, and investment resources with high productivity and reliability.

Technical support of the gas transmission system and underground gas storage

Key operations 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 36%, and annual fuel gas savings are estimated at about 76 million cubic meters. Commissioning of the station is planned for 2021.

- Reconstruction of Yagotyn 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 NVKG Zorya-Mashproekt. Reconstruction of Yagotyn compressor station envisages construction of a new station with installation of 4 new gas pumping units GPA-Ts-16C/57-1,7M1 of block-container design with a gas turbine engine and a centrifugal supercharger with a heat recovery unit. New GPAs 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.



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 PSO 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 our 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 can offer 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!



“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”

Maxim Rabinovych
Director, Retail Business Division

Retail business division

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

On August 1, 2020, Ukraine abandoned the PSO 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 PSO 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 82% 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:**
- Naftogaz prepared well for market liberalization and outperformed its plans in terms of client portfolio growth, increasing its customer base 2.5 times from 251 thousand households as of August 1, 2020, to 619 thousand households by the end of 2020 (and 901 thousand customers as of March 31, 2021).
 - Naftogaz proved itself a reliable partner to the Government and to Ukrainian customers, acting as Supplier of Last Resort (SLR) and backing customers up when their RSCs failed to continue their operations. Naftogaz of Ukraine Gas Supply

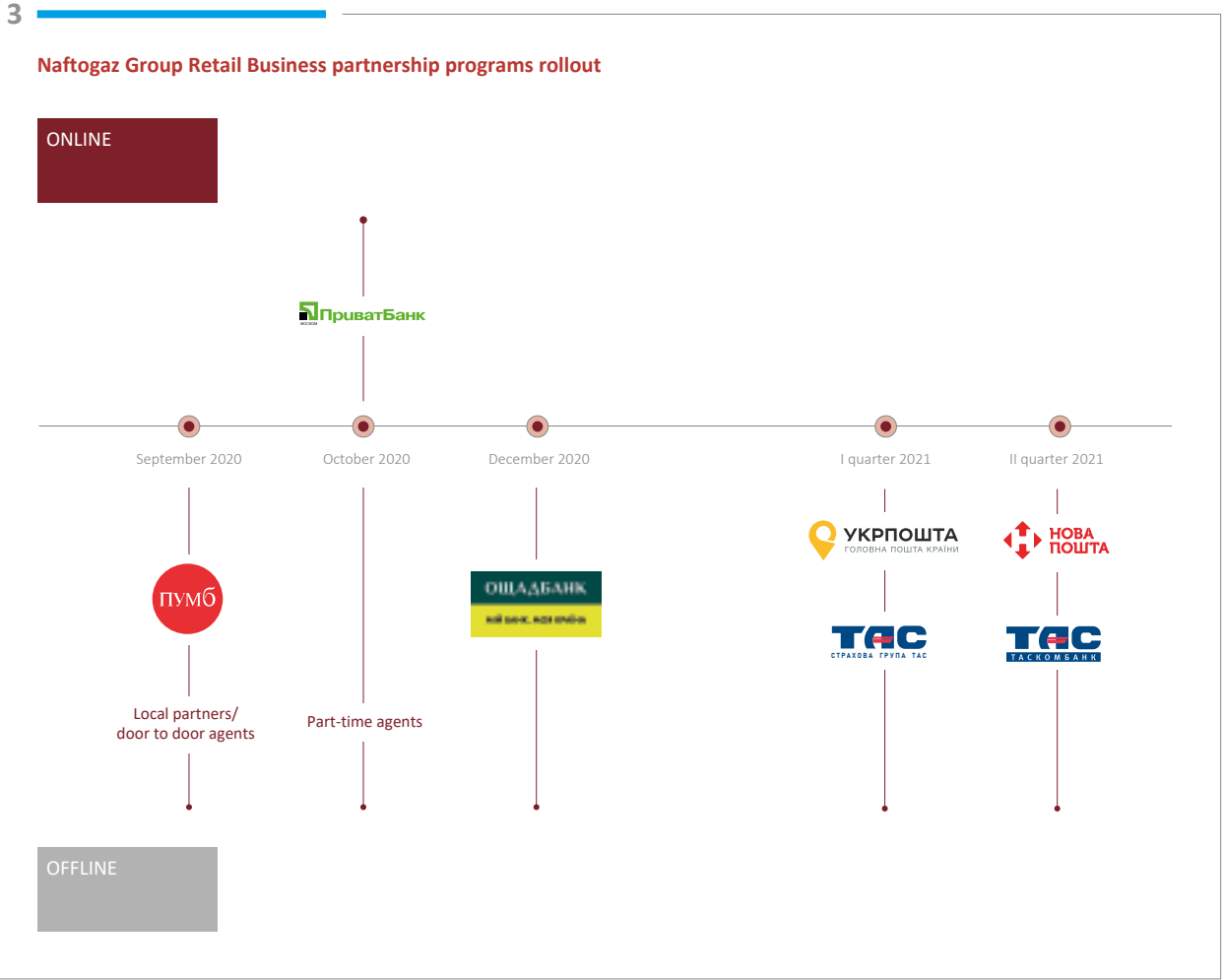
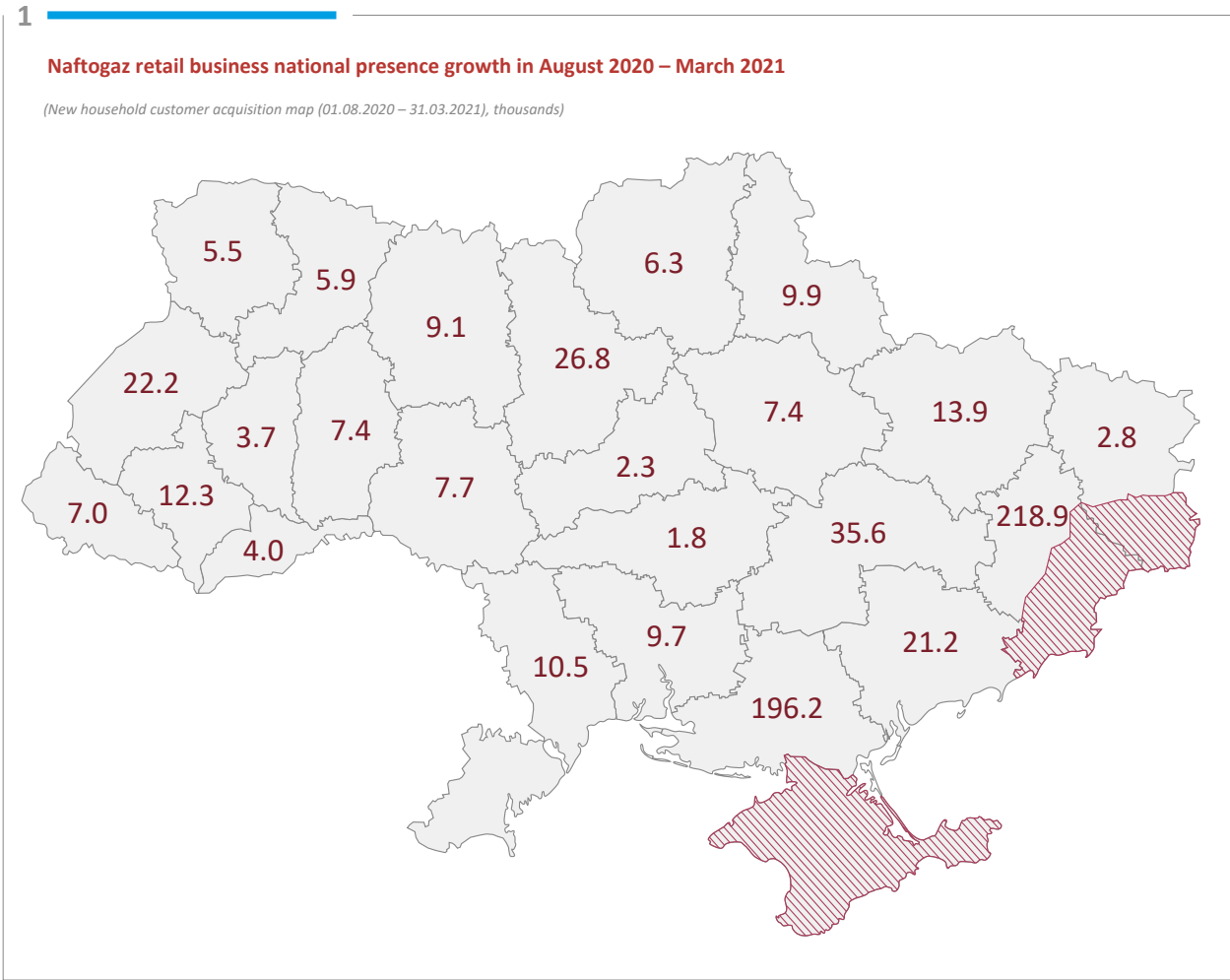
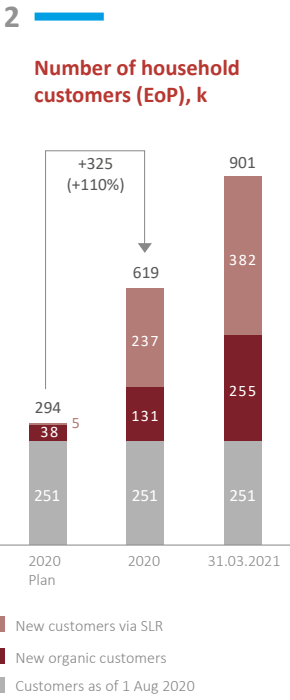
Company, as SLR, supplied gas to 800 thousand households as of Q1 2021.

- Naftogaz turned into a national natural gas supplier to households, expanding its presence into all Ukrainian regions through an effective partnership model both online and offline: in 2020, the company engaged nearly 2000 partner branches to subscribe and consult customers.
- 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 Kremenets 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, 432 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



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)

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

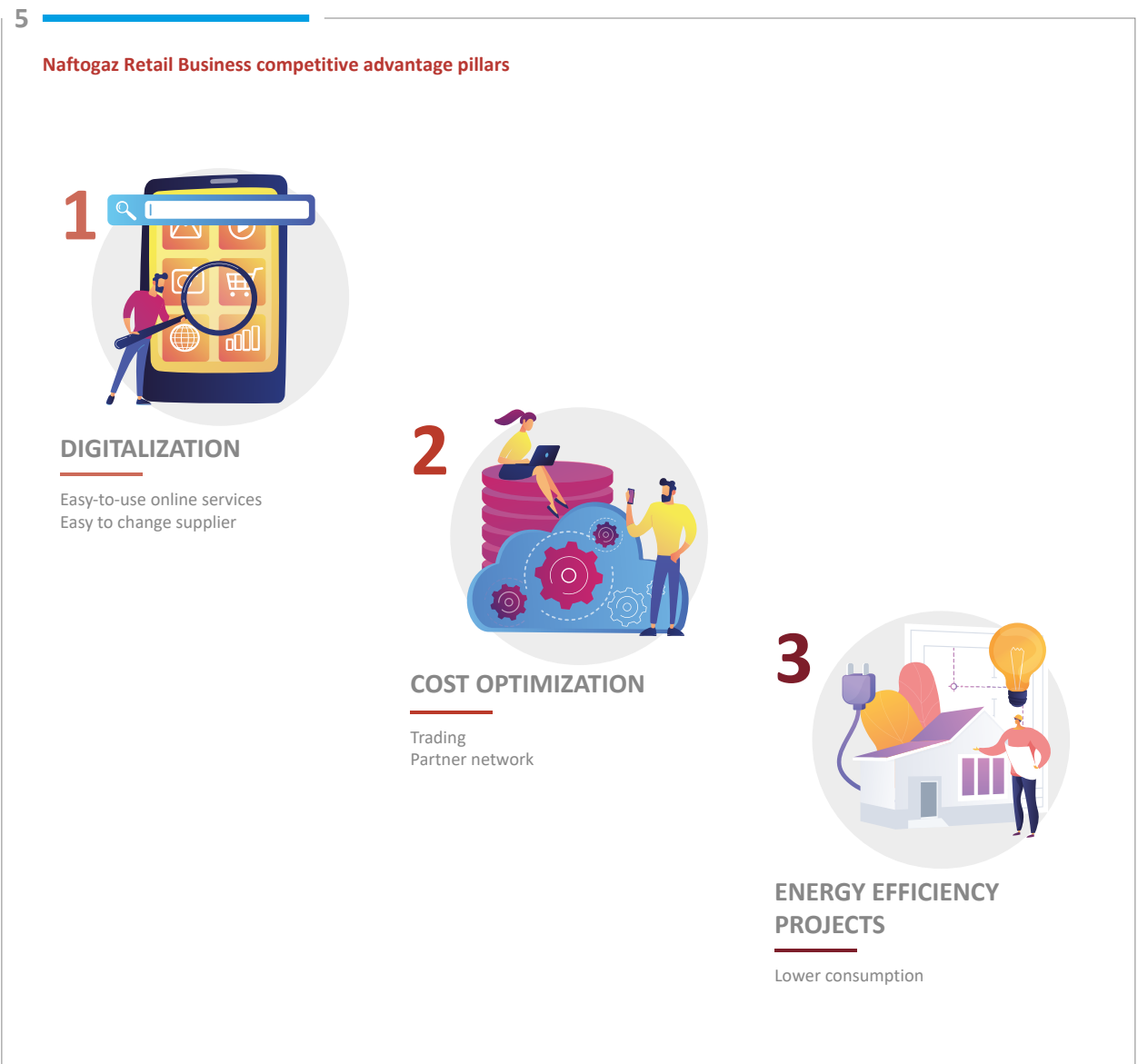
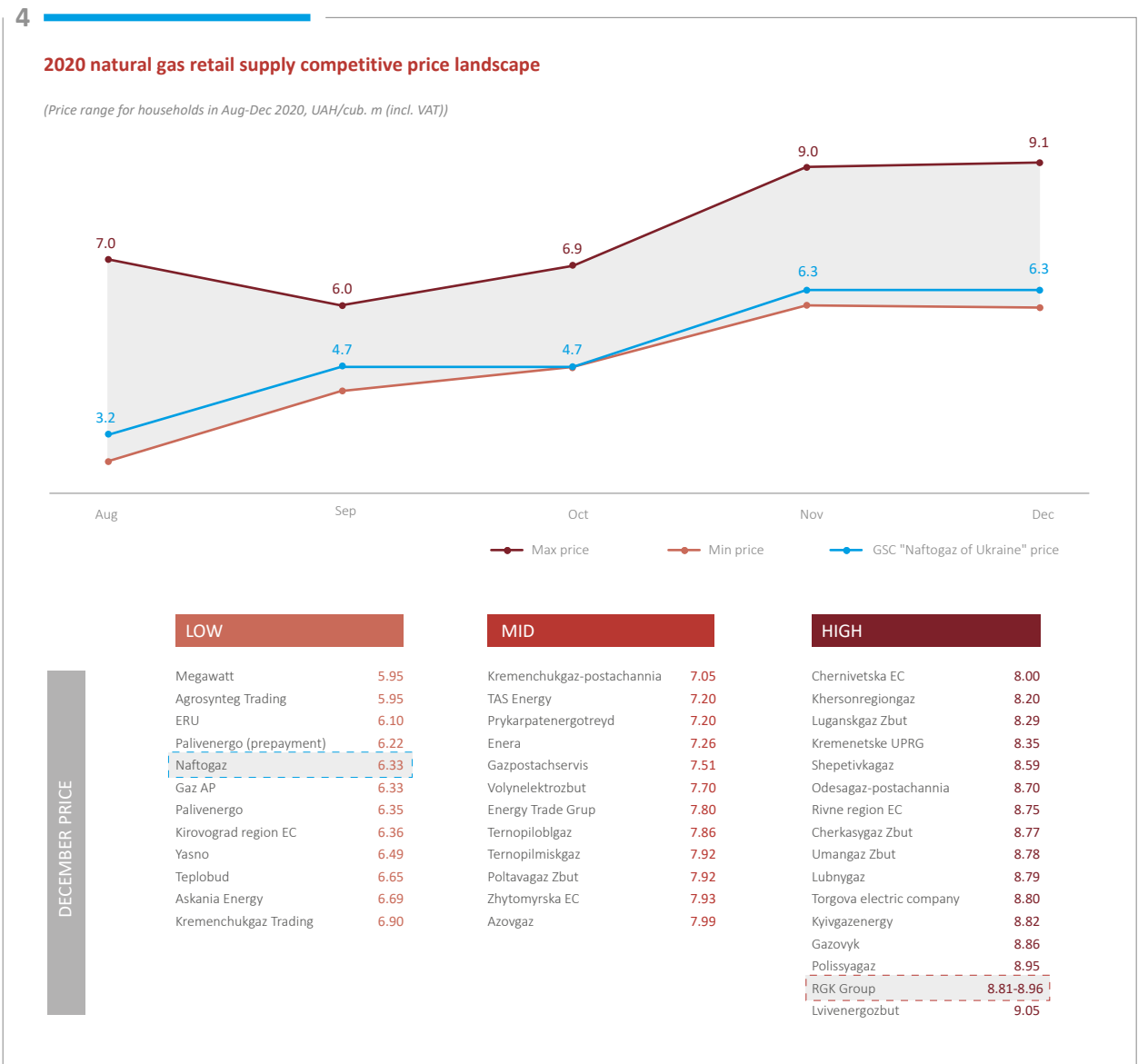
32% lower than the regulated sales price of UAH 6.99/m³ (including VAT) adopted in February 2021 by the government.

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.

Larger market share

+50 %
increase in retail sales in 2020 compared to 2019



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

KEY RESULTS OF OIL DIVISION:

Revenue of the Oil Midstream and Downstream Division (Oil Division) comprised UAH 11.5 bn in 2020, which is almost 11% less than the previous year. At the same time, revenue from the processing of liquid hydrocarbons, natural gas and sales of oil products, liquefied and compressed gas was UAH 6.8 bn, or about 60% of the Oil Division's total revenue.

EBITDA comprised UAH 2.0 bn, which is 29% more than for the previous year, mainly due to successful trading operations, the positive effect of exchange rate changes, and reduction of operating costs.

Key results of the transit and transportation of oil and Liquefied Petroleum Gas (LPG) (Oil Midstream segment) in 2020 were the following:

- oil transit amounted to 13.2 million tons in 2020 (similar to 2019 level);
- volume of transit includes 0.9 million tons of oil, which was transported to Belarus via the oil pipeline on route Pivdennyi SOT – Brody – Mozyr. Revenue amounted to UAH 273.6 million;
- Ukrtransnafta launched video surveillance system for round-the-clock surveillance of Oil Division assets and infrastructure;
- in terms of the development of trading activities, despite the global crisis, additional revenue of UAH 772 million was received as a result of a successful trading operation with crude Azeri Light oil;
- transportation of LPG by rail in 2020 amounted to about 310 kt, which is 35% less than the previous year (476 kt);
- revenue of the segment of UAH 4,709 million, of which UAH 3,742 million revenue from the transit and transportation of crude oil by main oil pipelines, and

UAH 772 million was revenue from trading operations on the purchase and sale of crude oil, as shown above.

Key results of activities related to the processing of liquid hydrocarbons, natural gas, and sales of oil products, liquefied and compressed gas (Oil Downstream segment) in 2020 were the following:

- the volume of processing of liquid hydrocarbons at the Shebelynka GPP decreased to 423 kt compared to 473 kt in 2019;
- sales of oil products and liquefied gas of own production to external consumers were 519 kt (540 kt in 2019);
- sales of compressed natural gas (methane) in 2020 were 35.4 mscm, which is 7.1% lower than the previous year;
- net profit of the raw materials processing segment and sales of oil products in 2020 was almost UAH 5.8 bn.

The Oil Division combines such activities as transit and transportation of oil and liquefied gas, processing of natural gas, liquid hydrocarbons, sale and trade of liquid hydrocarbons, liquefied gas, oil products (wholesale and retail), and sales of compressed gas. The scope of the Oil Division includes the operations of Ukrtransnafta, Ukrspetstransgaz, a branch of the Gas and Gas Condensate Processing Division of Ukrgasvydobuvannya, Ukravtogaz and Naftogaz Oil Trading (subsidiary of Ukrtransnafta).

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

- 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 the system in the direction to Belarus, and increasing the volume of transportation in Ukraine.
- 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. ¹

Ukrtransnafta also provided oil storage services for 91.8 thousand tons and booking services for 13.0 thousand tons.

OIL TRANSIT TO THE REPUBLIC OF BELARUS

Provision of oil transportation services to the Republic of Belarus takes place under an agreement between Ukrtransnafta and BNK (UK) Limited (Great Britain), which is a subsidiary of CJSC Belarusian Oil Company. During 2020, within the framework of the agreement with BNK (UK) Limited, Ukrtransnafta accepted ten oil tankers with 886 thousand tons volume at Pivdennyi SOT.

Ensuring the transit of oil to Mozyr 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 UKRTRANSNAFTA OIL PIPELINE SYSTEM

On 8 January 2020, Ukrtransnafta completed the displacement of Russian oil with high content of organochlorine compounds from the Ukrainian section of Druzhba oil pipeline to the Slovak-Ukrainian border, and 21 January, to the Budkovce 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 unitson quality parameters. In addition, Ukrtransnafta has equipped a specialized laboratory of international standard at Brody LODS. 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 it 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 CJSC Belarusian Oil Company. The sale was carried out on ITT terms from the tank farm of Pivdennyi Sea Oil Terminal, with further transportation of oil by pipeline from the terminal to Mozyr Oil Refinery.

In addition, Ukrtransnafta sold 10 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 Ukrgasvydobuvannya 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.

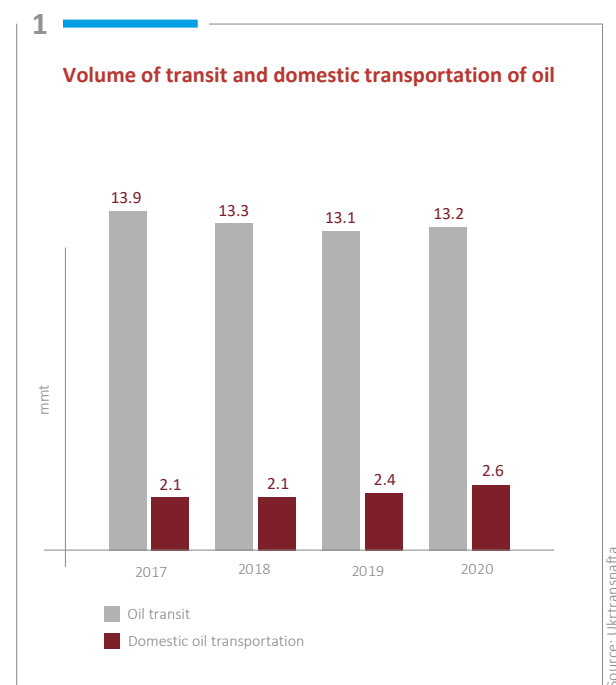
MEASURES FOR THE MODERNIZATION AND RENOVATION OF PUMPING UNITS OF THE DRUZHBA OIL PIPELINE

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 pumps of oil pumping units that had been in operation at the station since 1976. They were replaced by three new energy-efficient Ukrainian-made 20NDSN-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 and through 2020, Ukrspetstransgaz's performed its economic activities in the conditions of significant changes in trends and market conditions. I 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



tons. The company provided LPG transportation and transit from Ukrainian producers, import and transit of LPG from Belarus and the European Union, as well as through the seaports of the Black and Baltic Seas.

In 2020 Ukrspetstransgaz continued transportation of the petrochemical products manufactured by Karpatnaftokhim LLC for export and isopentane fraction from the Republic of Belarus for the needs of JSC Ukrgasvydobuvannya.

It should be noted that in 2020 the volume of LPG transportation from LPG manufactures decreased by 17% in Ukraine due to the reduction of domestic production and significant (over 80%) dependence of LPG market in Ukraine on import most of which were from the Russian Federation.

During 2020 in pursue of diversification business the company carried out investment activities for technical re-equipment and production modernization. Ukrspetstransgaz didn't use loans to implement its investment projects.

Improved engineering support allowed creating logistic hub on the basis of the company's assets to perform services for receipt, storage and LPG transportation. This resulted in greater efficiency of the company: during 2020 the company accepted for storage and transportation from rail to road 5.8 thousand tons of LPG. Additionally 4.0 thousand tons of LPG were sold through gas network and small wholesale lots, thus diversifying the company's sources of revenue. This market segment was constantly monitored.

Financial and economic indicators are, on average, were at the normative level. The company fully fulfills its obligations in terms of net transfers to the State Budget of Ukraine and shareholder.

In 2020 Ukrspetstransgaz showed zero work-related injuries.

During 2020 the company donated for charity as assistance to Dolyna General Hospital in the amount of 406.0 thousand UAH to purchase oxygen supply equipment for artificial lung ventilation.

TRANSFER OF SEIZED PROPERTY OF PRYKARPATZAHIDTRANS 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 Prykarpatzakhidtrans 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".

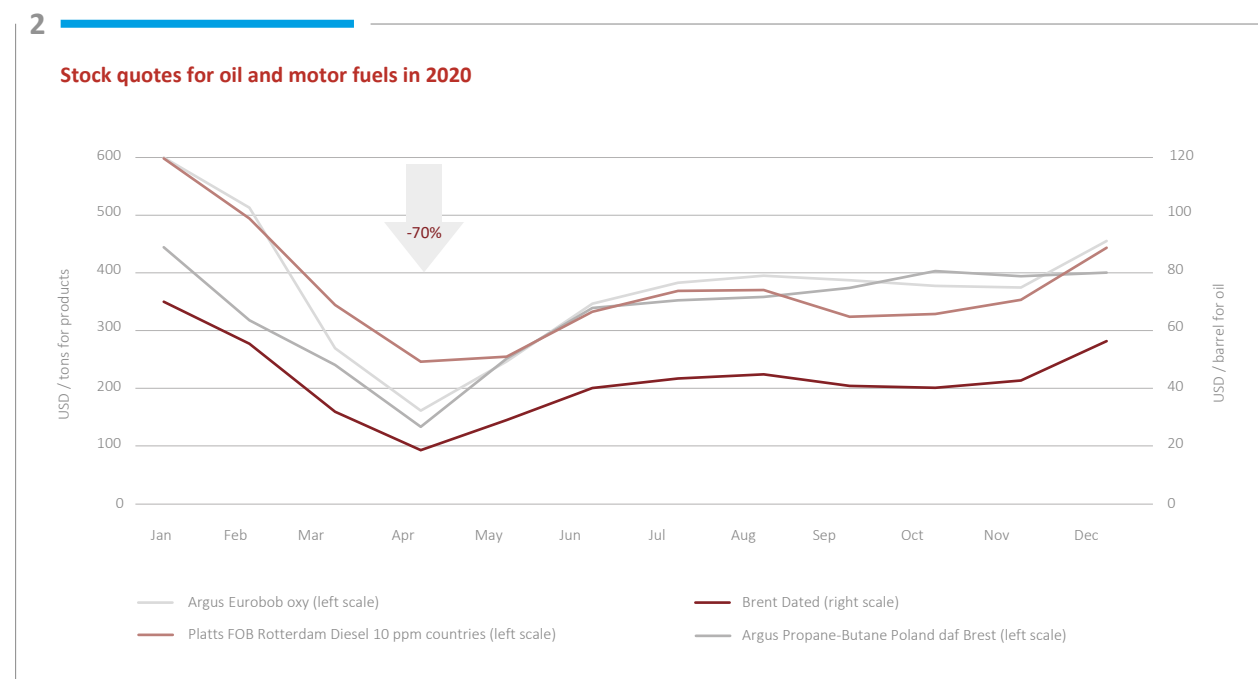
In April 2021, the Asset Recovery and Management Agency, based on the results of the tender, elected Ukrtransnafta to manage part of Samara-Western Direction oil pipeline.

In 2020, Prykarpatzakhidtrans 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.

stock quotes for hydrocarbons in April 2020 fell three times, showing an abnormal decline. This has led to the temporary

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

2020 was a year of challenges, both for the oil industry as a whole and for Ukrgasvydobuvannya's oil refining business. World



shutdown of many refineries around the world, problems with the sale of fuel products, and the disruption of production and logistics chains.

More than 90% of the raw materials received for processing at the Shebelynka GPP came from the company, which significantly complicates the ability to maneuver with the raw material pool and related costs.

In order to mitigate sales risks, in July 2020, Ukrgasvydobuvannya sold motor fuels (gasoline and diesel fuel) under long-term annual contracts, and increased price differentials by 30-40%. The company therefore received an additional economic boost from the sale of fuel products under long-term annual contracts of USD 3.6 million. **2**

In 2020, the volume of liquid hydrocarbon processing at the Shebelynka GPP decreased to 423 thousand tons, compared to 473 thousand tons in 2019. The total volume of processing, including additives and components, amounted to 446 thousand tons, which is 51.8 thousand tons or 10.4% less than in 2019. The light fuel product extraction rate was 92%, compared to 89% in 2019. **3**

At the same time, the production of motor fuels decreased during 2020: gasoline dropped to 139.7 thousand tons (by 9.5 thousand tons or 6.4% compared to 2019); diesel fuel fell to 75.1 thousand tons (by 13.1 thousand tons or 14.8%). The decrease in liquefied gas production at Ukrgasvydobuvannya's production facilities to 144.3 thousand tons (by 8.3 thousand tons or 5.5%) was due to reduction of hydrocarbon supply volumes for processing assets. **4**

In 2020, Oil Midstream and Downstream Division sold 519 thousand tons of petroleum products and LPG of its own production to external consumers (540 thousand tons in 2019). In addition, 45 thousand tons of petroleum products (mostly diesel fuel) were shipped to domestic consumers, primarily to the Technical Division, to supply the operations of its drill and workover rig fleet. The vast majority of diesel, gasoline and LPG was sold at the Ukrainian Energy Exchange, while only 16

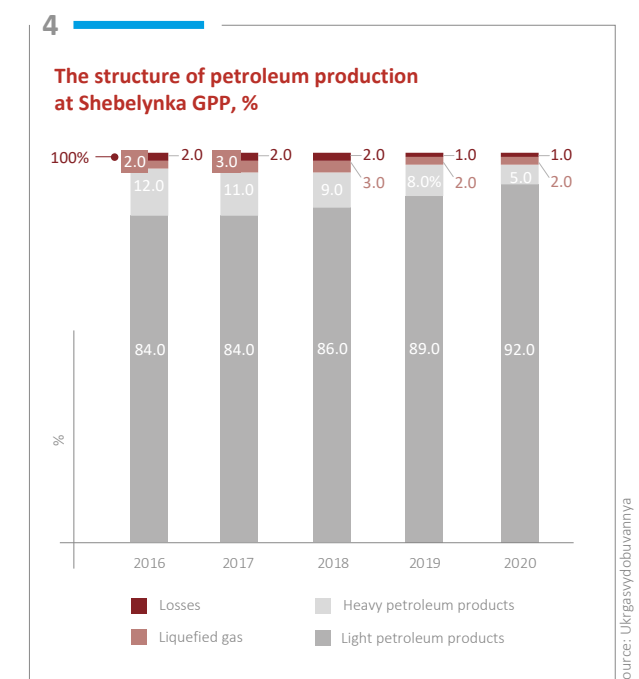
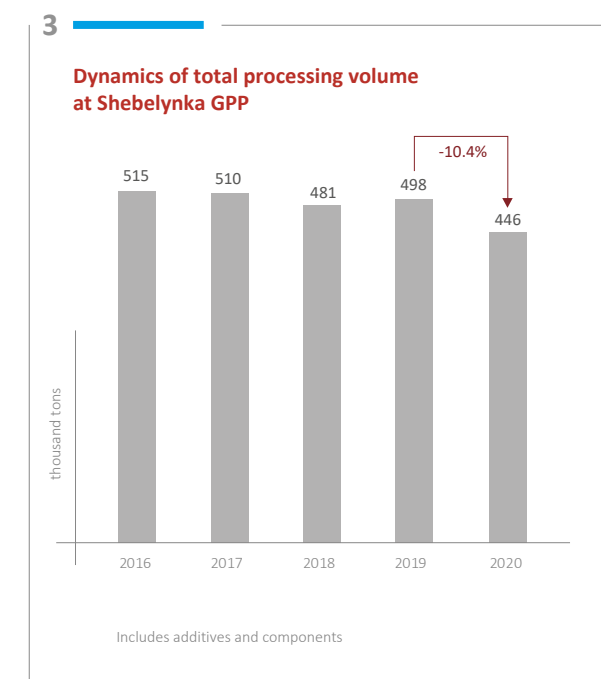
thousand tons of petroleum products and liquefied gas were shipped through the own gas station network. At the same time, fuel products such as reformat, benzene-containing fraction and fuel oil were mainly exported.

Improving operational and commercial efficiency of refining and selling petroleum products and LPG.

Key initiatives to increase operational efficiency in 2020 were the following:

- product group diversification – active production of new types of products – Arctic diesel fuel and A-80-DZ gasoline (long storage);
- accreditation of 4 stationary laboratories for gas and product quality control with the National Accreditation Agency of Ukraine (NAAU) for compliance with the requirements of DSTU ISO / IEC 17025:2017 in testing of fuel products, LPG and CNG. As a result of successful accreditation, all Shebel production units have their own laboratories, which enable performance of a full range of testing of oil and gas raw materials and refined products both for their own needs and for customers. In addition, in 2020 1 petroleum product quality control mobile laboratory was launched. It is equipped with the necessary equipment to determine the quality of fuel products using express methods and can quickly determine the main indicators of quality of fuel products at the sampling point;
- expansion of Ukrgasvydobuvannya's geography of retail sales under the Shebel brand through a partner gas stations network in 10 administrative regions of Ukraine. Shebel fuel can already be purchased in Kyiv, Zhytomyr, Chernihiv, Kharkiv, Dnipropetrovsk, Zaporizhia, Poltava, Sumy regions and in the government-controlled districts of Donetsk and Luhansk regions.

In the future, Ukrgasvydobuvannya is considering scaling up the gas station network that sell Shebel fuel, increasing the level of brand awareness, and using of branded products among end consumers in the regions with a product presence.



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 BNK-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.

The company plans to increase the volume of supply and sales, expand the range of petroleum products, launch new sales bases and enter the electricity market.

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 propanebutane vehicles by carrierse;
- 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.

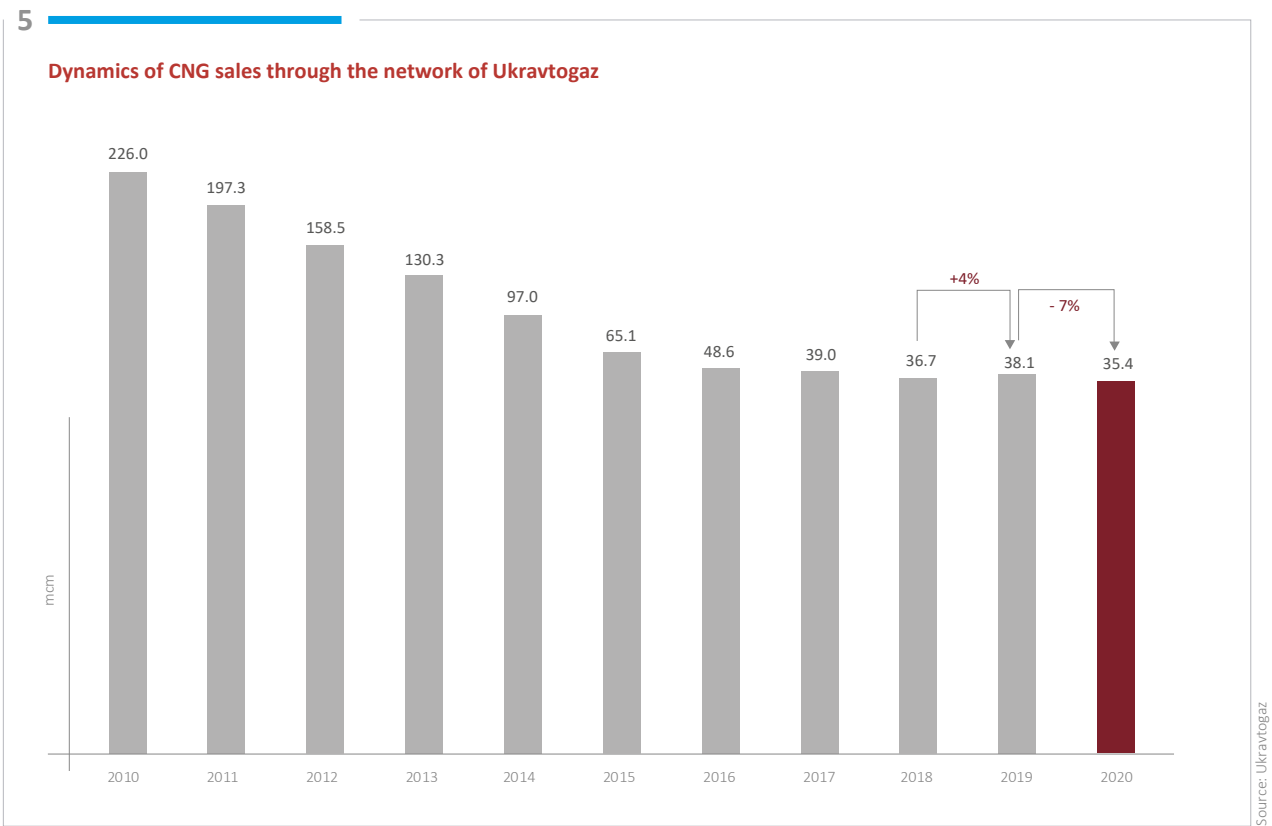
STRATEGIC INITIATIVES TO INCREASE THE VALUE OF THE OIL DIVISION IN THE SEGMENT OF HYDROCARBON REFINING AND SALE OF OIL AND CONDENSATE

The key strategic initiatives of the Oil Division in the segment of hydrocarbon refining and sales 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 hydrotreating 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 Khrestyshensky 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 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.



PJSC Ukrnafta results

- Ukrnafta maintained oil and condensate production at the level of 2019.
- Despite the unfavorable conditions of 2020, the company was able to demonstrate a positive financial result.
- As a result of coordinated actions of Naftogaz, Ukrnafta and support of the Government, the debt repayment mechanism had been fully settled and the state was able to compensate Naftogaz for fulfilling the public service obligations imposed on the company while allowing Naftogaz to make payments to Ukrnafta.

PRODUCTION

Despite lockdown conditions and a significant decrease in oil and gas prices, the production volume of Ukrnafta was stable at the level of the previous year. In 2020, production of liquid hydrocarbons amounted to 1.5 mln tons, which is 1% less than in 2019, with the average daily production of oil and condensate – 4.1 thousand tons per day. **2**

Natural gas production was 1.13 bcm, down 3% compared to 2019, with an average daily production of 3.1 mcm/day. Production of liquefied gas increased by 4.5% to 117 ths tons.

Given that Ukrnafta operates on fields with a significant degree of depletion, the production figures indicate that the company managed to compensate for the high rate of natural production decline. In 2020, Ukrnafta focused on operations at the existing well stock: transition to new productive horizons, recompletions, optimization of capital, and planned workovers and replacement of the outdated equipment.

In total, last year, Ukrnafta completed 4 hydraulic fracturing operations, 133 capital workovers, performed 24 operations with coiled tubing units without a workover crew, 20 production intensification operations, and took 107 wells out of non-operation. These operations allowed the company to produce additional 145.4 ths tons of oil and condensate and 79.4 mcm of natural gas. **1**

The company continues introduction of remote monitoring of wells equipped with electric submersible pumps (ESP). In 2020, 34 wells were added to the system. The system now covers 207 wells.

An important step towards improving operational efficiency was the opening in December 2020 by Ukrnafta in Pryluky 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.

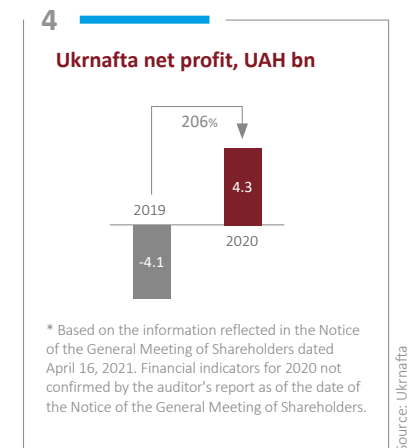
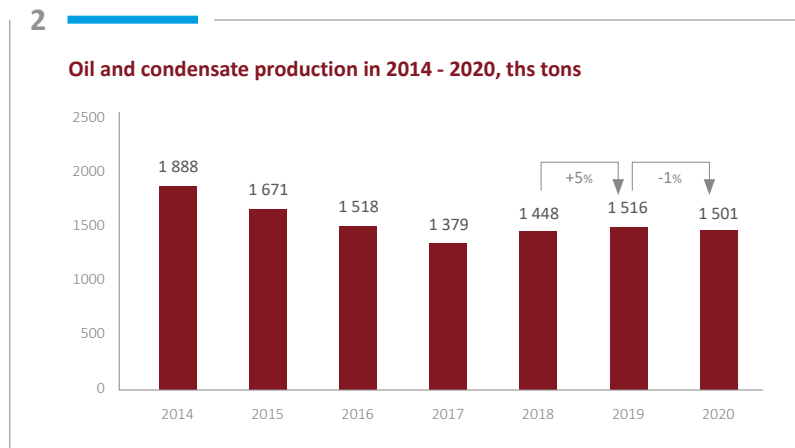
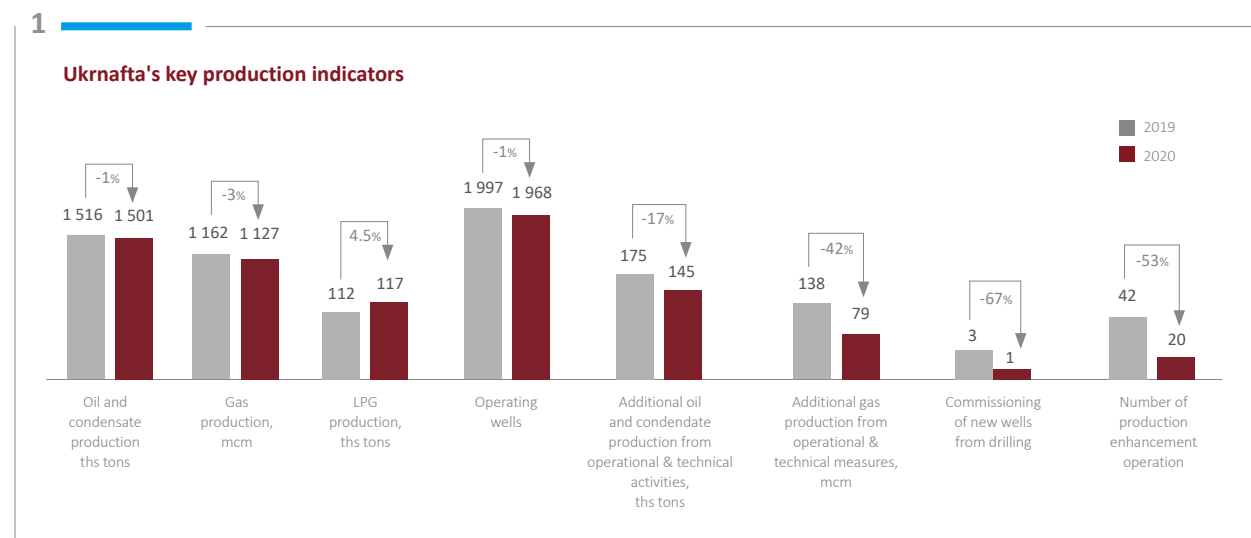
OIL AND PETROLEUM PRODUCTS SALES

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 rebranded 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 rebranded filling stations in Rivne, Ternopil, Zhytomyr, 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.

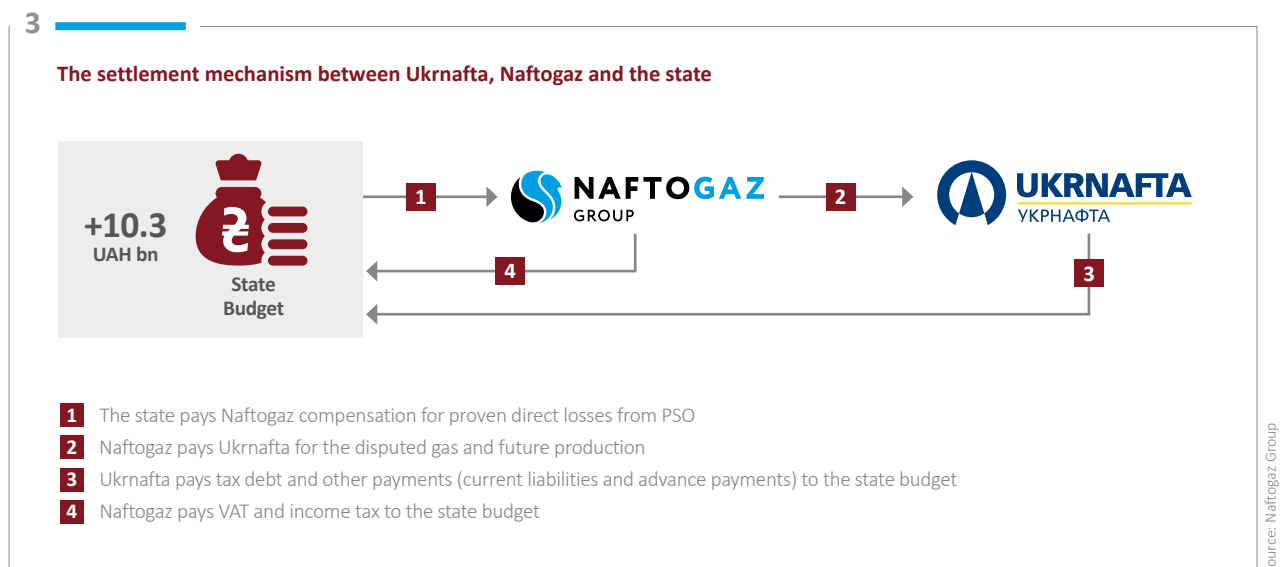
In 2020, according to the schedule of exchange auctions for the sale of crude oil and gas condensate of PJSC Ukrnafta production, 21 auctions were organized. During the period from January 1, 2020 to December 31, 2020, the sale of raw materials took place at only 8 auctions. Due to below market prices 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 on the Ukrainian Energy Exchange. Before that, Ukrnafta had been selling oil on the Ukrainian Interbank Currency Exchange for almost 20 years. The highest selling price of Ukrnafta oil was in January – UAH 13,545/ t (including VAT), the lowest price in April- UAH 4,480/t (including VAT). In addition, Ukrnafta sold 4.4 ths tons of gas condensate on the UEEX worth UAH 27 million (including VAT) at prices of UAH 5,795 and UAH 6,198 /t (including VAT).

REPAYMENT OF LEGACY TAX DEBT – SETTLEMENT BETWEEN NAFTOGAZ, UKRNAFTA, AND THE GOVERNMENT

In December 2020, the Ministry of Energy of Ukraine paid Naftogaz of Ukraine a compensation for the supply of imported gas during 2015-2019 within the framework of the regime of special obligations (PSO) on the natural gas market. During this period, Naftogaz sold gas at a regulated price below the market price for the needs of the population, budgetary, and religious organizations. In total, the compensation amounted to UAH 32.2 bn. **3**

Within the framework of implementing the agreements between Ukrnafta and Naftogaz on the purchase and sale of natural gas, Naftogaz paid Ukrnafta UAH 15.1 billion for 2.061 bcm of natural gas produced in 2006. In addition, Ukrnafta received an advance payment of UAH 23.5 billion for the supply of natural gas of future production. The company expects to supply gas under the prepayment over the next few years. In turn, Ukrnafta returned a UAH 2.5 bn loan to Naftogaz of Ukraine, which the company received earlier this year for payment of VAT liabilities, which arose in the process of natural gas sales.



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 11% 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. ⁴

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.



3. TRANSFORMATION: HOW WE WORK

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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 a 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 avoiding 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 the 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-100 – a group of change leaders, which includes middle managers from all divisions and functional areas of the Group. Their involvement and support is the basis of planned fundamental and irreversible changes. An individual 5-month modular program «Leadership during Transformation» was developed to support the change leader growth.

A similar course was delivered to senior management (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

STRATEGIC GOALS OF NAFTOGAZ <ul style="list-style-type: none">— Increasing payments to the budget— Overcoming of import gas dependence— Increasing of gas reserves— IPO-readiness	TRANSFORMATION OF NAFTOGAZ <ul style="list-style-type: none">— Organization transformation— Leadership & culture— Business-processes reengineering— Business-strategy execution
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Naftogaz Group transformation successes in 2020

ORGANIZATIONAL TRANSFORMATION	<ul style="list-style-type: none">— 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	<ul style="list-style-type: none">— 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	<ul style="list-style-type: none">— 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, screensavers, 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 <ul style="list-style-type: none">— 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 rightsizing implementation that focused on divisions and corporate functions	2021 Strategic initiatives implementation <ul style="list-style-type: none">— 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 <ul style="list-style-type: none">— Agile & effective operating model— Modern SCM— Digitalization— Industry IRR— Production targets fulfilled— Strategic projects/products focus— Cost control— Fulfilled people and organizational potential
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2021 priorities: value-adding drivers

GOVERNANCE More focus on Value adding	<ul style="list-style-type: none">— Delegation of Authority— Performance management implementation (business-processes KPIs, OKRs 2021 approach, 360-degree assessment)— Organizational standards development & implementation— Corporate values unification & consolidation— Executive Board approval process optimization
OPERATING MODEL Effective services & interfaces	<ul style="list-style-type: none">— BDs & CFs critical interfaces (Business partners models & SLA standards, Client satisfaction survey)— BPs register updated & owners— New BDs & CFs establishment, structure updating— Management Policy updating— Simplification: optimize & consolidate branches & LEs— Improving the efficiency of supply chain management
OPERATIONAL EFFICIENCY Critical KPIs & deliverables	<ul style="list-style-type: none">— 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	<ul style="list-style-type: none">— Expand Change management to support all critical BPs— Communication plan development & implementation:— Project management system implementation— Group Corporate portal: project launching— HR environmental & OHI improvement— Group-wide Methodology & Standards database launching— Group-wide Implementation of behavioral standards and rules of cross-functional cooperation
COMPETENCIES DEVELOPMENT Our professional future	<ul style="list-style-type: none">— Leadership program top-50— Critical Competences 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, focus on results, high ethical standards, expertise, and cooperation. High corporate conduct standards are ensured by the Code of Corporate Ethics¹. All employees regardless of their responsibilities or position 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 jobs;
- satisfying job;
- decent salary;
- perks.

Last year, which was saw the launch of the Naftogaz Group transformation in the context of a new operating model, the corporate HR function of the Group was established, which meant the centralization of multiple HR management processes: remuneration management across the Group through centralized evaluation of performance on strategic objectives and consolidated payroll management; supporting the establishment of eight business divisions and 11 corporate functions. Having designed the Group’s functional structure and each position within individual corporate functions in cooperation with the relevant team leaders, our HR professionals built a framework for the future organization. In 2020, we laid the foundations of our future success.

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. Naftogaz supervisory board member Nataliya Boyko shared our successful remote work practices on the International Platform in her report at the USAID Energy Security Annual Round Table devoted to COVID-19 relief.

HUMAN RESOURCES POLICY OF NAFTOGAZ GROUP

As part of the implementation of Corporate Strategy, the Human Resources Policy of Naftogaz Group was introduced in 2020². 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 line³. 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

B 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 contests 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). **1**

Most Naftogaz Group employees are men – 76.0% (39,485). Women make up 24.0% (12,462). 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 – Ukrnafta (40% or 20,763 persons), Ukr gasvu-dobuvannya (34.1% or 17,727 persons), Ukrtransgaz (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 – 4,908 persons (9.4%), and over 50 – 15,230 persons (29.3%). Employees of retirement age amount to 2,028 persons (3.9%). **2**

The share of Naftogaz Group employees involved in production of crude oil and natural gas was 27.2% (13,799 persons), land and pipeline transportation – 12.0% (6,087 persons), and other operations of the Group’s production enterprises 60.8% (30,777 persons). **3**

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 Ukrtransgaz 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 Ukrtransnafta led to a decrease in the number of employees compared to 2019;
- the rightsizing of Ukr gasvydobuvannya staff involved in auxiliary, supporting, and non-core functions that are not part of the company’s core business activities, including the downsizing of Ukrburgaz drilling unit due to a substantial decrease in annual drilling targets;
- the reorganization of Ukrnafta 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 quantitative 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 workforce, outgoing labor migration of qualified workers, higher inflation and cost of living, etc.

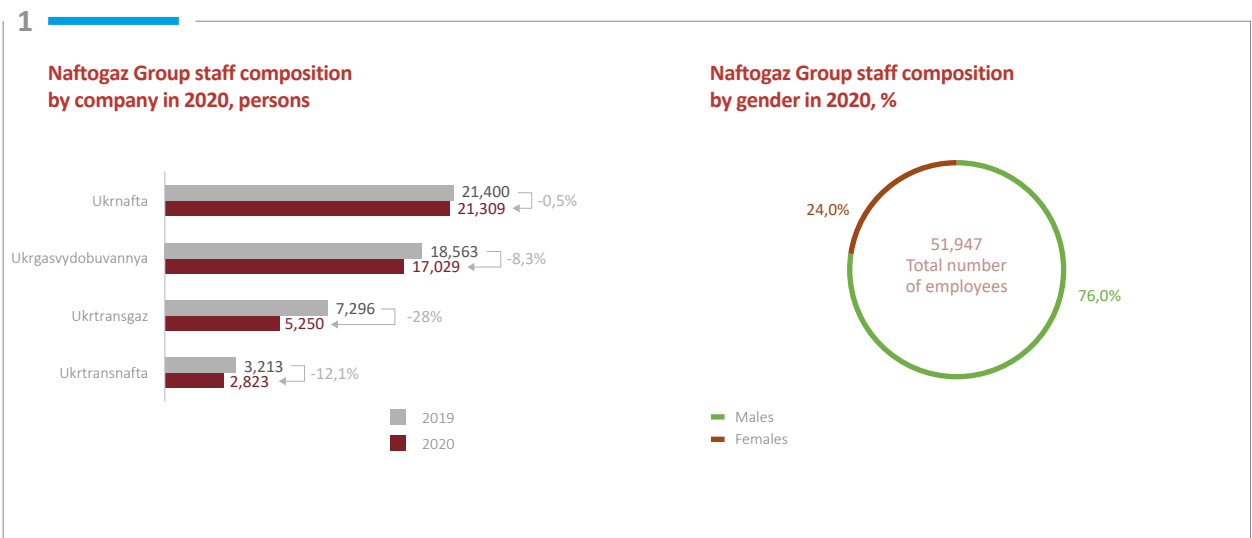
SOCIAL SECURITY

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 2,008.2 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). **4**

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 Ukrtransgaz employees having been transferred to the GTS Operator, and the downsizing in Ukrtransnafta.

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



Ukrtransgaz to the GTS Operator as part of unbundling also contributed to the decrease in expenses.

Lower expenses on employees’ wellness was due to COVID-19 and quarantine restrictions in Ukraine, which prevented full implementation of the company’s wellness campaign.

Meanwhile, healthcare expenses increased due to public health measures to prevent acute respiratory diseases and coronavirus among employees and the purchasing of medical equipment, medicines, disinfectants, protective gear, laboratory tests, anti-viral drugs, etc.

Besides social security expenses, Naftogaz Group’s trade unions received UAH 158.6 million for culture, sport, and healthcare activities in 2020.

STAFF ASSESSMENT AND CAREER MANAGEMENT

Company employees pursue clear and comprehensible objectives and key results identified by using the Naftogaz Group OKR tool. Staff assessment is made based on both individual and team results. When deciding on the career growth of Naftogaz Group employees, the following factors are considered: professional and technical skills, competencies, performance, motivation, and initiative. To ensure a transparent assessment process, the company enables effective communication of employees and their direct supervisors regarding objectives and results.

The company implemented models for corporate and leadership competencies based on corporate values and developed behavior indicators that help identify how strong those competencies are, and plan training and career development programs. Last year, as part of a joint project with NExT/ Schlumberger, Ukgasvydobuvannya held an assessment of its exploration and production staff, using special questionnaires and software. The assessment aimed at developing requirements to technical skills of exploration and production specialists, and creating a motivating environment for them. Based on the assessment of 570 specialists, training and professional improvement plans were developed to bridge identified gaps in their technical competencies.

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 25,530 Naftogaz Group employees passed training and professional improvement programs: 58.7% – Ukrnafta, 36,6% – Ukgasvydobuvannya, 3.0% – Ukrtransgaz, 1.3% – Ukrtransnafta, 5 and other (Ukravtogaz, 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 7.70 for Ukgasvydobuvannya, 2.35 for Ukrtransgaz, 2.28 for Ukrtransnafta, 6 0.79 for Ukravtogaz, and 15.00 for Naftogaz of Ukraine Gas Supply Company.

UKGASVYDOBUVANNYA

In 2020, in order to improve professional skills of its employees, Ukgasvydobuvannya continued active cooperation under concluded agreements with international leaders Nabors Drilling International Limited, Shlumberger, 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.

Ukgasvydobuvannya’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.

Ukgasvydobuvannya 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 trainers. The program was extended for 2021 and is to be scaled to other Naftogaz Group companies.
- 5,046 Ukgasvydobuvannya employees improved their professional skills or were retrained in the training center of Shebelynkagazvydobuvannya.
- HSE training sessions were held. A program of the National Examination Board in Occupational Safety and Health was introduced for Ukgasvydobuvannya 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 basics of management.

NAFTOGAZ OF UKRAINE

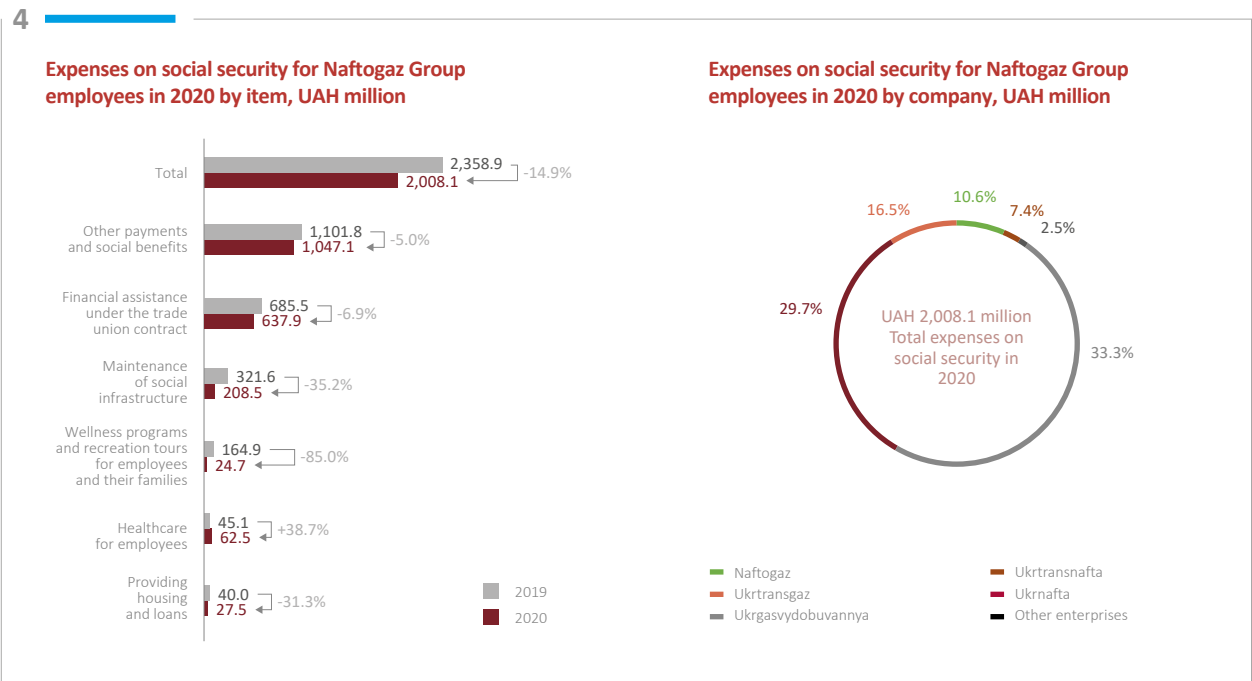
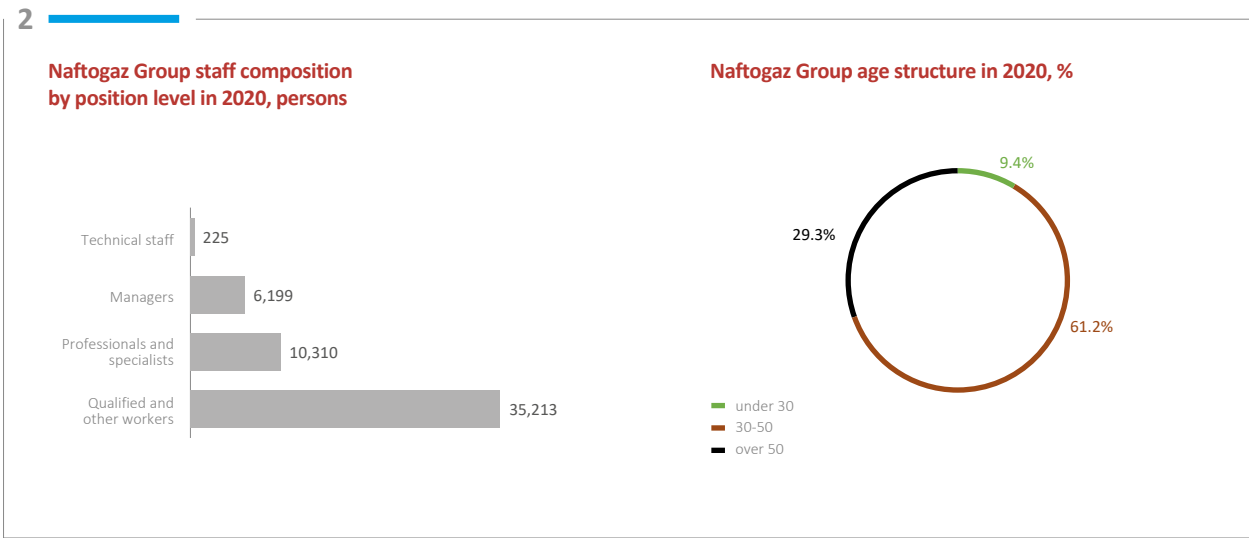
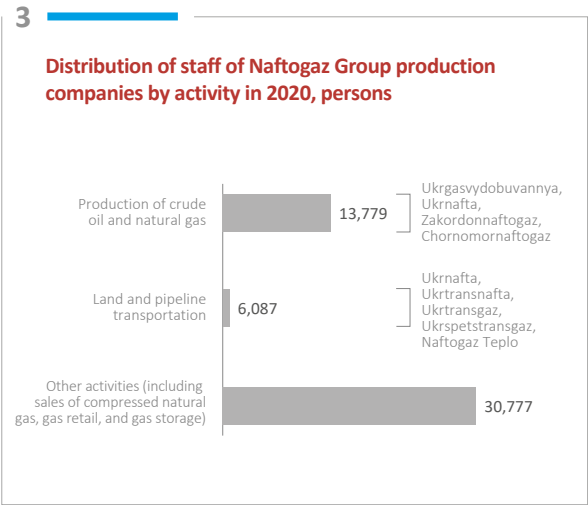
In 2020, Naftogaz of Ukraine NJSC introduced a Professional Improvement and Development Plan. 240 employees participated in various training activities in the reporting period. 364 man hours were held, including Finance for Non-Financial Managers and Business Analysis corporate training events.

2,008.2 UAH million

Naftogaz Group spending on social development and events

158.6 UAH million

payments to Naftogaz Group trade unions



MBA PROGRAM AT THE KYIV SCHOOL OF ECONOMICS

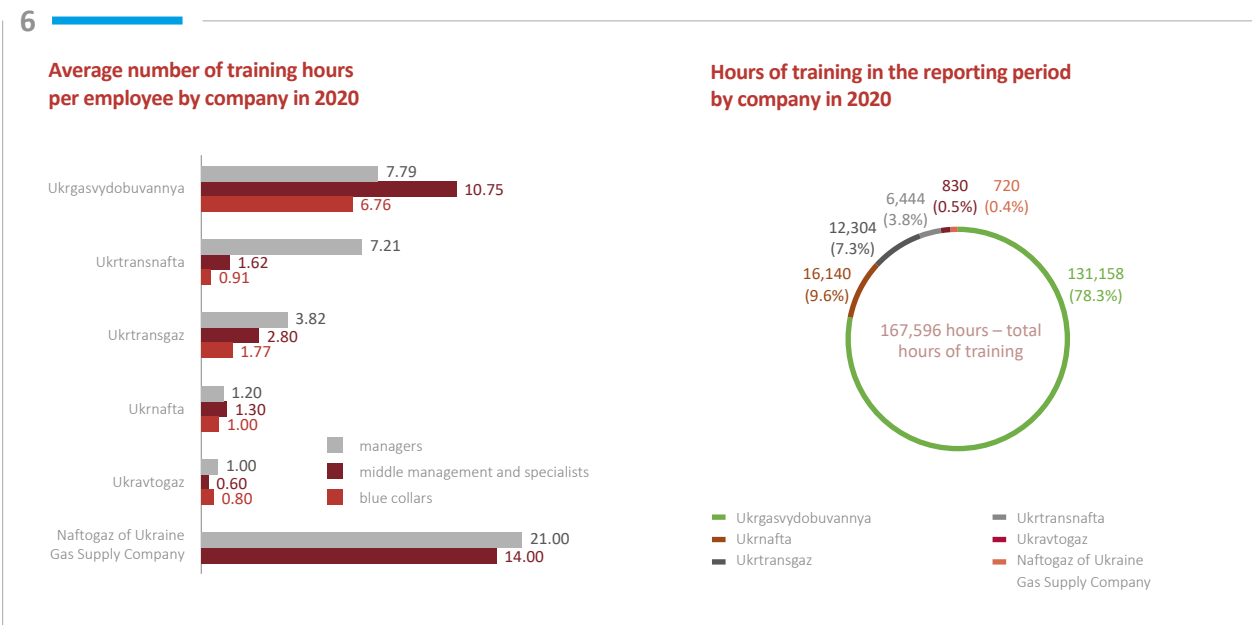
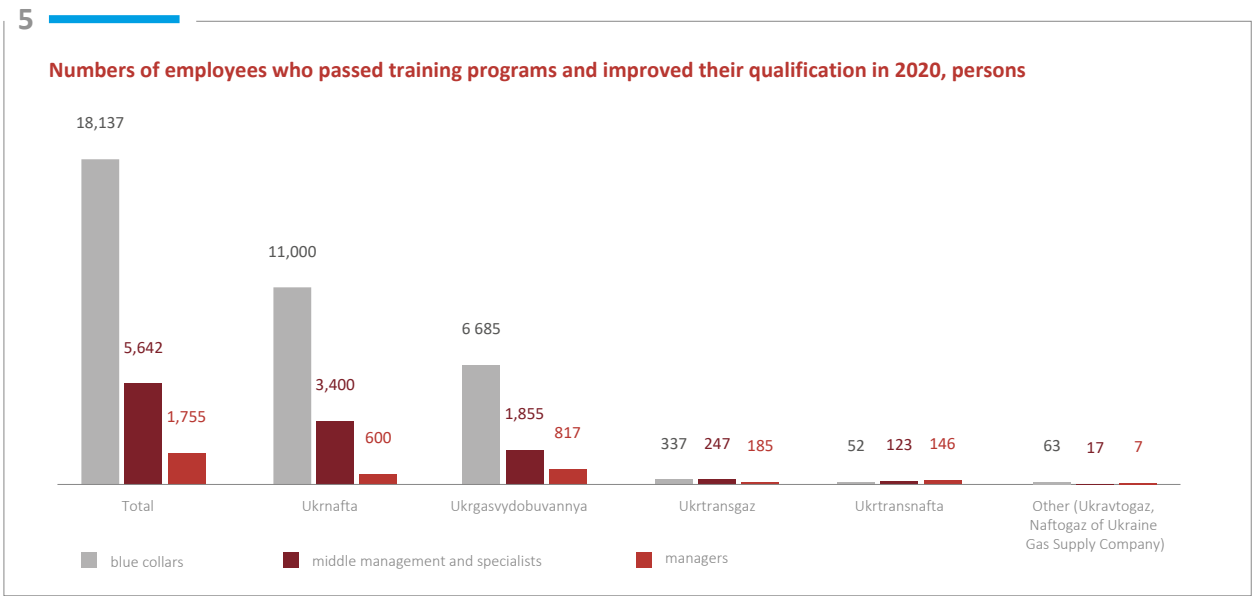
Naftogaz Group trade unions initiated the extension of an MBA SOE Management Program at the Kyiv School of Economics, a long-term training project for high-potential employees. The program featured participation by employees of Naftogaz of Ukraine, Ukrtransgaz, Ukrigasvydobuvannya, Ukrtransnafta, Naftogaz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

Ukrigasvydobuvannya 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, Ukrigasvydobuvannya 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.

- Launch a project for the design of a unified Human Capital Management system for all Naftogaz Group companies. The project is aimed at the development and implementation of a highly productive operating model, modernization of infrastructure, digitalization, and boosting Naftogaz Group's reputation in Ukraine.
- Develop leadership and managerial competencies (systemic thinking, change management, feedback, etc.) among Naftogaz Group managers of all levels.
- Organize training sessions devoted to the development of the oil and gas industry and project management.
- Promote in-house training among Naftogaz Group employees and developing in-house mentoring.
- Establish a club for graduates of the MBA SOE Management Program of the Kyiv School of Economics.
- Improve and develop the competency-based employee assessment system, including the development of functional competencies – a set of knowledge and skills required for specific jobs and positions. Hold evaluation of competencies to promote informed staff-related decisions and plan training activities.

COOPERATION WITH EDUCATIONAL INSTITUTIONS

In 2020, Naftogaz Group continued active cooperation with educational institutions.

Ukrigasvydobuvannya 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 trainers. The program was extended for 2021 and is to be scaled to other Naftogaz Group companies.
- 5,046 Ukgasvydobuvannya employees improved their professional skills or were retrained in the training center of Shebelynkagazvydobuvannya.

- HSE training sessions were held. A program of the National Examination Board in Occupational Safety and Health was introduced for Ukgasvydobuvannya 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 basics of management.

Occupational health and safety (OHS)

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 established standards and improve the existing level of OHS 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 Unified 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:

- Regulations for Occupational Health and Safety and industrial

safety hazard identification and risk assessment in Naftogaz Group.

- Regulations for the inspection of Naftogaz Group production assets for compliance with OHS, industrial safety, and environmental protection policies.
- Instruction on safe performance of works, tasks, and provision of services by third party organizations at the facilities of Naftogaz Group enterprises.
- Health, Safety, and Environment audit procedure within Naftogaz Group.
- Naftogaz Group occupational safety and health, industrial and fire safety, and road safety policy.
- Corporate management function responsible for occupational health and safety, civil protection, environmental, radiation, fire, man-made, industrial safety, road safety, and technical surveillance in Naftogaz Group.
- Draft Naftogaz Group regulations for the management of occupational safety and health, industrial and fire safety.
- Draft Naftogaz Group regulations for road safety management.

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").
- Action Plan to improve road safety of Naftogaz Group for 2021.
- Schedule of inspections of Naftogaz Group enterprises on occupational safety and health and road safety in 2021.

OHS COSTS

UAH 286.47 million – the total amount invested by Naftogaz Group in OHS activities in 2020.

The funds allocated by the company for OHS activities meet and even exceed the standard required by law – 0.5% of the

salary budget². Ukrnafta invested the most in occupational safety and health as a percentage of its salary budget – 3.03%, followed by Ukrspetstransgaz (2.70%), and Ukgasvydobuvannya (2.63%). **1**

In 2020, the companies of the Naftogaz Group spent a total of UAH 136.13 million, which is 47.5% of total OHS costs, to provide their employees with personal protective equipment, namely overalls, work shoes, fall arresting systems, safety helmets, goggles, respirators, noise-canceling headphones, protective gloves, etc. **2**

FIRE SAFETY

Naftogaz Group takes care of the organization and implementation of a fire safety system to ensure safe production processes. The Company fully complies with the provisions of the Civil Protection Code of Ukraine, fire safety regulations, orders, and relevant instructions of the Company. The Group has fire prevention arrangements in place regulated by the requirements of the Fire Safety Regulations (NAPB) A.01.001-2015 «Fire safety rules in Ukraine» and the standard SOU 75.2-20077720-017:2013 "Naftogaz of Ukraine NJSC Fire Safety Management System. Substantive provisions".

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.

Naftogaz Group provides sufficient personnel and material support for fire safety function:

- As of 2020, Naftogaz Group employed 169 fire safety specialists, including 88 full-time employees. In addition, 160 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 ponds, 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. **3**

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 aerosol disinfection systems for employees.

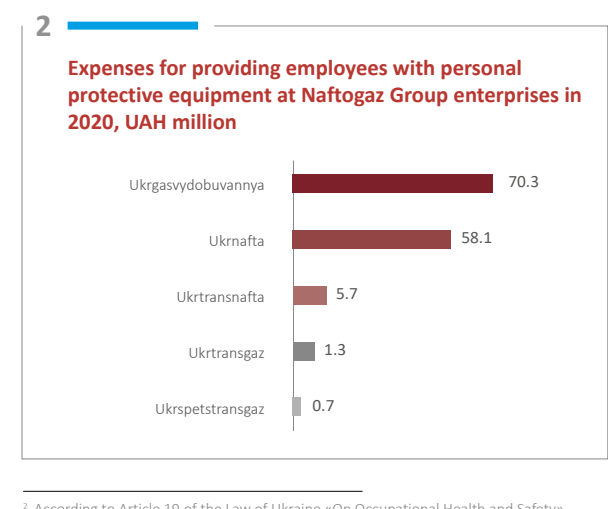
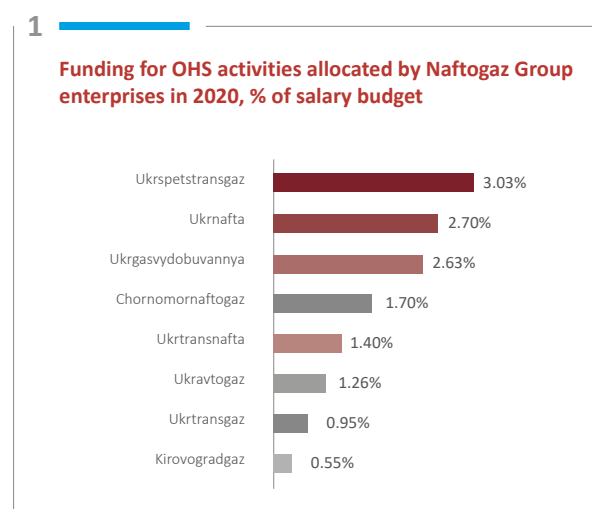
Measures to prevent the spread of coronavirus were carried out at enterprises, branches, and structural subdivisions of Naftogaz Group, including:

- mandatory protective masks;
- availability of disinfectants;
- daily systematic body temperature measurement;

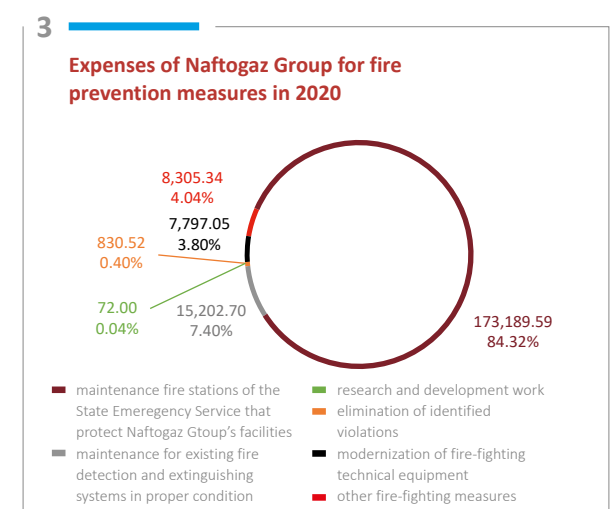


In 2020, Naftogaz Ukraine was certified by the certification agency TÜV SÜD Management Service GmbH for compliance with the international standard ISO 45001:2018 «Occupational Health and Safety Management Systems».

¹ The standard is based on DSTU OHSAS 18001:2010 «Occupational health and safety management systems» standard



² According to Article 19 of the Law of Ukraine «On Occupational Health and Safety»



— 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 OHS 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);
- “Management system auditing in accordance with the requirements of ISO 14001:2015, ISO 45001:2018 and ISO 50001:2018. Internal audits and lead auditors. Best practices”;
- “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 previous year (34 cases in 2019). 21 workers were injured at work, namely:

- 12 accidents, including 1 group accident: 13 employees of Ukrgasvydobuvannia were injured;
- 1 group accident: 2 employees of Ukrtransnafta were injured;
- 4 accidents: 4 employees of Ukrnafta were injured;
- 2 accidents: 2 employees of Ukrtransgaz were injured;
- no accidents in the Naftogaz of Ukraine head office in the reporting period.

The accident frequency rate³ in 2020 was 0.425 (0.615 in 2019), and the severity of injuries rate⁴ – was 41.57 (75.83 in 2019). The loss of time due to accidents at work⁵ amounted to 908 man-days (2,654 in 2019). **4**

Most accidents at work resulted from organizational failures: 15 accidents, or 79% of the total number of accidents (17 employees were injured). The other 3 accidents occurred due to technical reasons

(3 employees were injured) and 1 case due to psycho-physiological reasons (1 employee was injured). **5**

The most common organizational causes were:

- failure to comply with the requirements of occupational safety regulations (7 employees were injured);
- violation of public road transport safety regulations (5 employees were injured);
- violation of machinery, plant, and equipment safety regulations (3 employees were injured);
- lack of personal protective equipment (1 employee was injured);
- violation of technological process (1 employee was injured).

Technical causes of the accidents were:

- non-compliance of collective and individual protection equipment with established standards or lack thereof (1 employee was injured);
- unsatisfactory technical condition of machinery, plant, and equipment (1 employee was injured);
- others, namely technical failure of electric circuit breaker (1 employee was injured).

Psycho-physiological causes include the victim’s personal negligence, which caused one injury in 2020. **6**

In addition, 6 premature (sudden) deaths not related to the production process were recorded at Naftogaz Group enterprises during the reporting period: 4 at Ukrgasvydobuvannya JSC, 1 at Ukrnafta PJSC 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 of 17.04.2019 No 337. 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.

SAFETY OF OIL AND GAS TRANSPORTATION

In order 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 8 sets of anode groundings of cathodic protection stations, 23 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:

- 39 thefts 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. Of

these, 17 incisions were equipped with taps with a total length of 21,031 m;

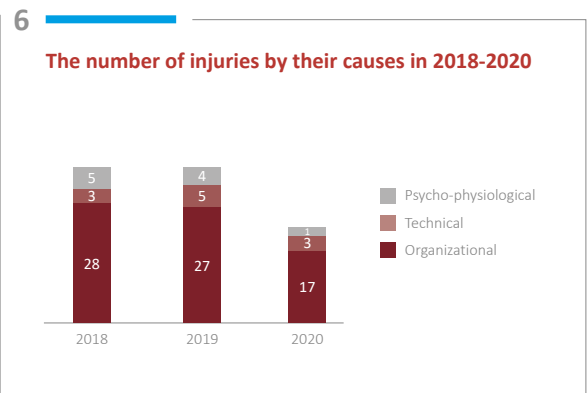
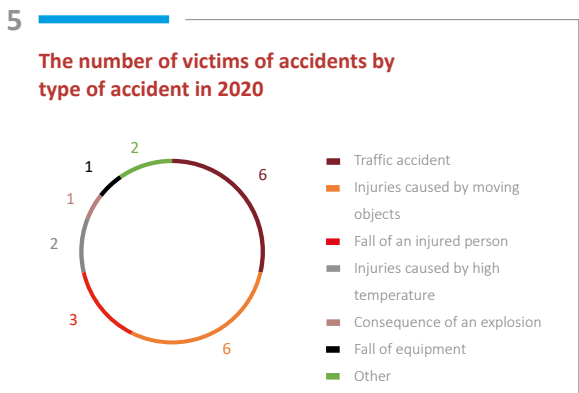
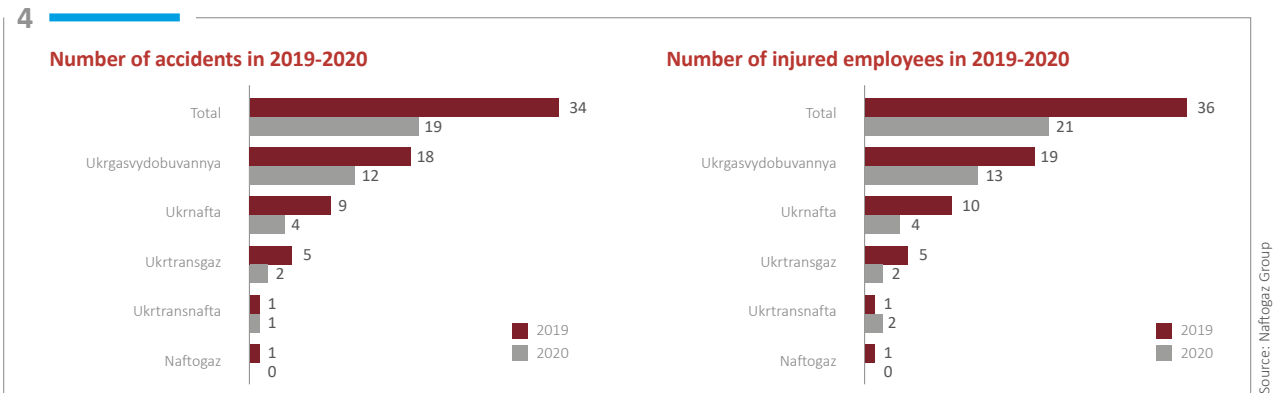
- 31 damages to technological equipment, i.e. pipeline electro-chemical protection systems, fountain fittings of wells, crane units, etc.

Illegal incisions to pipelines were identified on the territory of 9 regions of Ukraine: Dnipropetrovsk region – 7, Lviv region – 8, Poltava region – 15, Kharkiv region – 4, Kirovohrad region – 1, Mykolaiv region – 1, Rivne region – 1, Sumy region – 1, and Khmelnytsky region – 1.

In order to detect and prevent 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 pipeline areas, which allows 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.

PLANS FOR 2021

- implementation of measures to prevent workers from contracting coronavirus infection COVID-19;
- launch of corporate occupational safety and health, 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.



Effective procurements



Olga Borodina
Chief Procurement Officer of Naftogaz Group

Procurement of equipment, materials and services is a key activity in the Naftogaz Group supporting Group’s core business delivery. In March 2021, within the transformation of Naftogaz, all procurement processes were united into a single function for more competitiveness and effectiveness. We will take the best that is available in the international procurement practices whilst being fully compliant with Ukrainian public procurement law. We will make transparent and cost effective procurement choices and will be a catalyst for the development of the Ukrainian economy.

We will continue the implementation of the category management for main spend categories, which has successfully started in 2020. The category management will allow us to gain deeper understanding of the supplier markets, aggregation of the demand across the Group, standardization of technical specifications and contract terms and development of competitive procurement strategies. Naftogaz will further step up in its professionalism in managing contracts and steering improvements in the supplier performance. All these measures will lead to the reduction of the total cost of ownership of the equipment and services that we procure.

Compliance with the public procurement legislation is essential for our delivery and Naftogaz will ensure that the learnings from the recent public procurement activities are captured and are taken into account in the future procurement. We will continue to create the equal playing field for our suppliers. In the same time we will seek to reduce the bureaucracy and inefficiencies in our procurement processes and effective usage of available systems and increasing the level of automation in procurement.

I am convinced that the combination of these steps will ensure timely delivery of the required equipment and materials to sustain our business, help to develop long-term high performing partnerships with our contractors and suppliers and support the delivery of Naftogaz Group’s overall mission.

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 operation 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 RACI-flowcharts (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 USD 100-150 million.

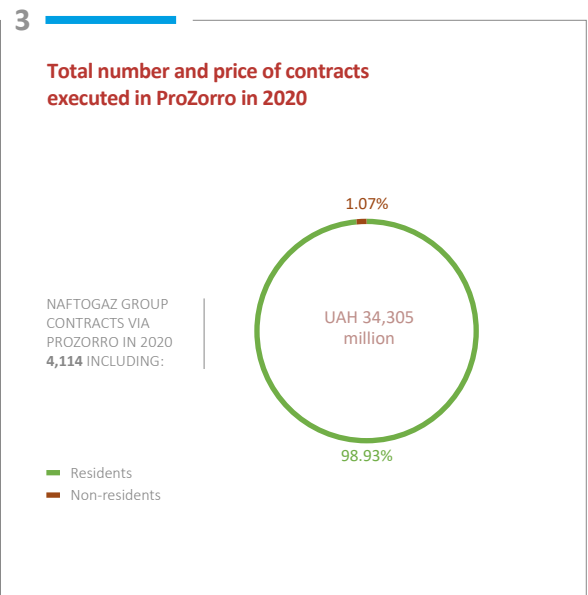
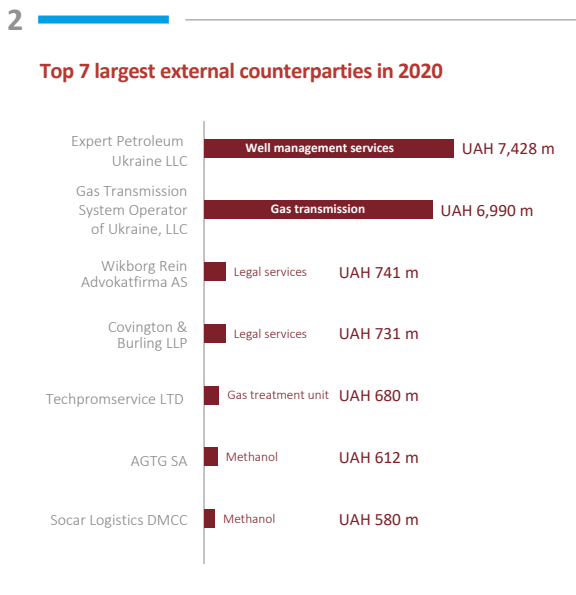
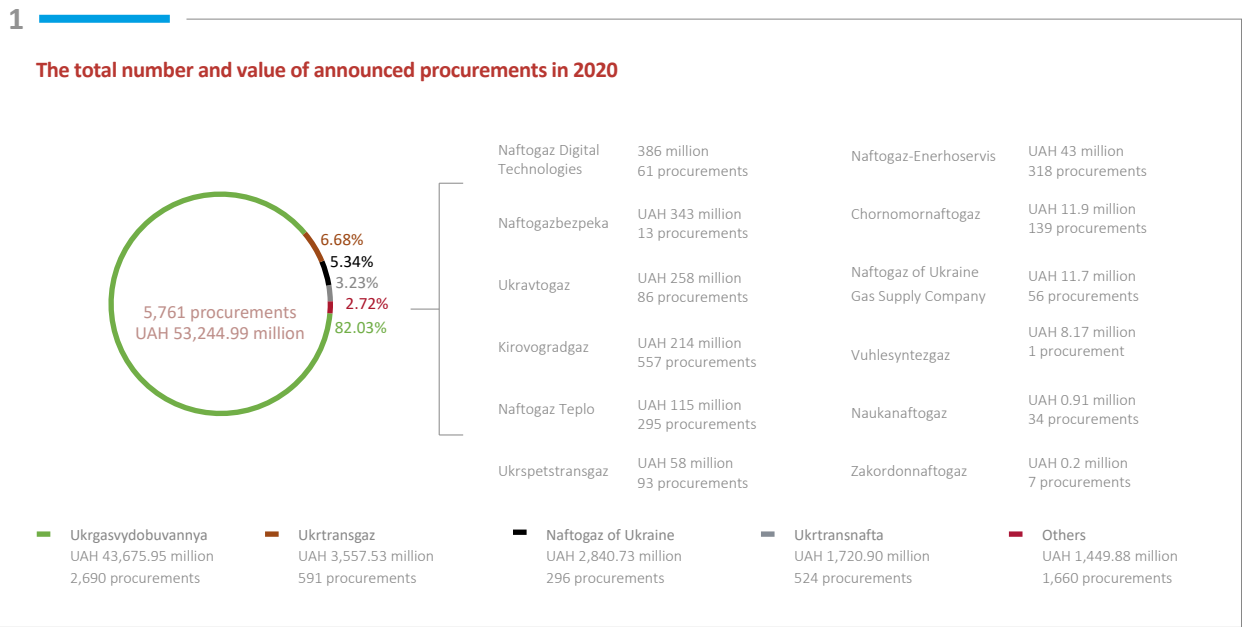
Also during 2020, the detachment of the procurement control function began. The newly established independent contract boards and contracting departments at all levels of Naftogaz Group companies provide for supervision over the correctness of procurements. First of all, the independence of control is 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.

During 2020, Naftogaz Group companies, as and when necessary, continued to effectively apply support requirements and measures of additional environmental control to participants in procurement procedures.

In late 2020, preliminary negotiations were held with the Ministry of Economy regarding the possibility of using factoring in procurements with a view to attracting more bidders and increasing competition in biddings.

In March 2021, as part of this transformation, it was decided to change the procurement system and turn it into a separate corporate function, which will be centrally responsible for all procurement of the Group. The updated structure meets the



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.

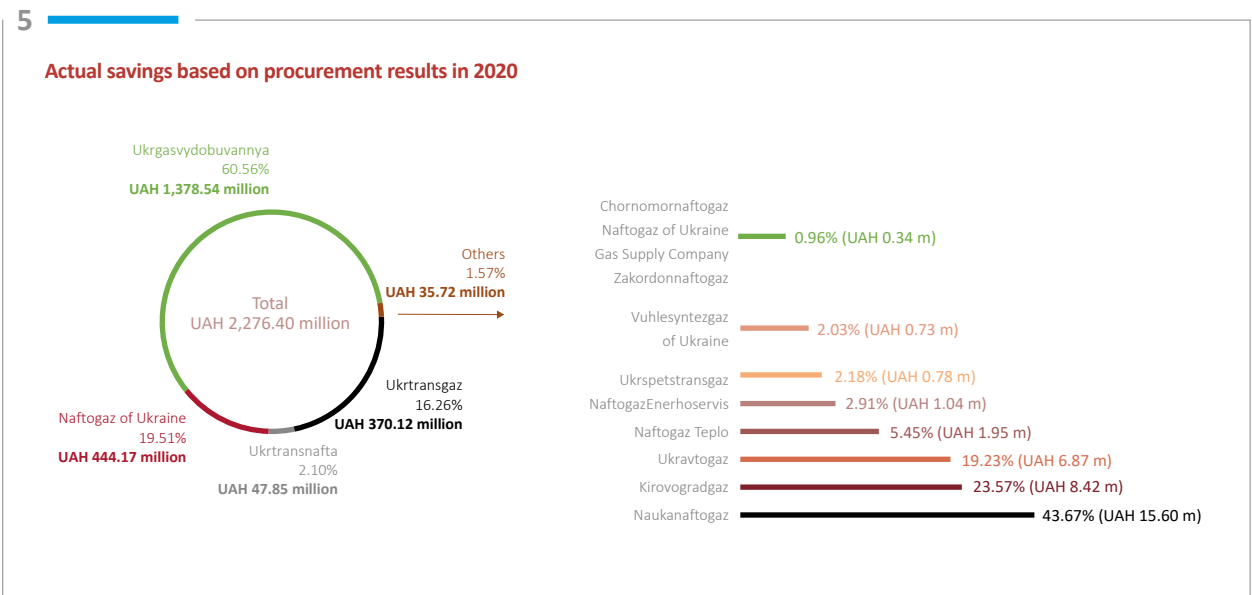
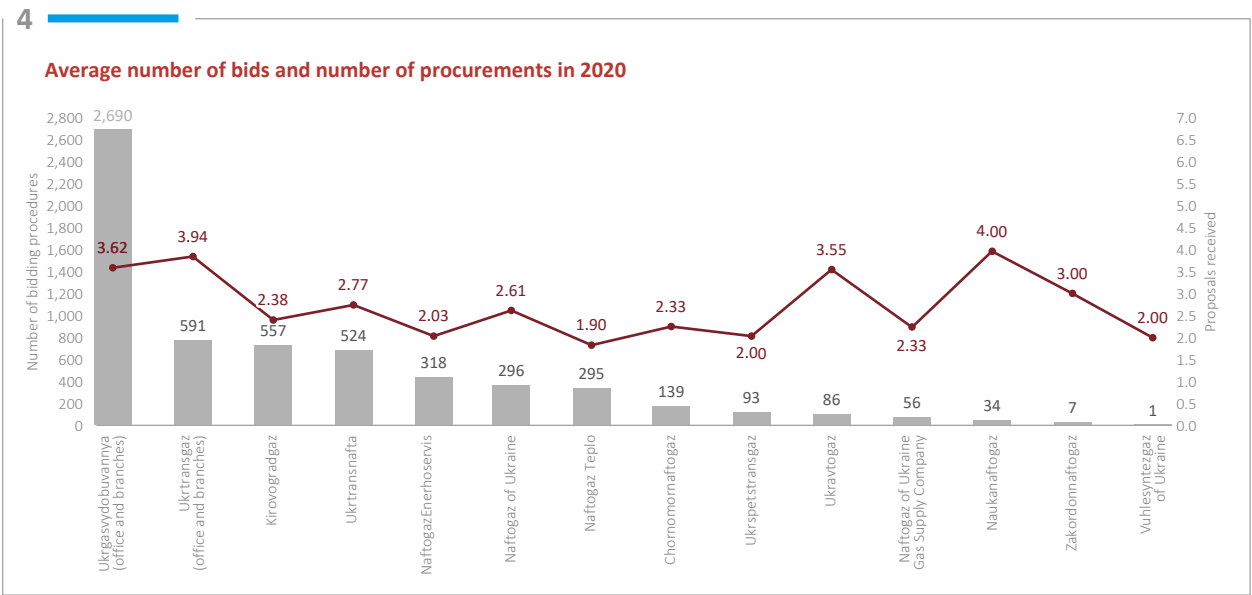
In 2020, the Group’s companies placed 4,114 contracts worth UAH 34,305.00 million in ProZorro, 98.93% of which were entered into directly with residents. At the same time, 89% of the total procurement budget was spent on local suppliers registered in Ukraine. In 2020, the actual savings according to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

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.

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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Address of Supervisory Board member

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.



“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”

Bruno Lescoeur
Supervisory Board member

Corporate governance

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

The approval of the Naftogaz of Ukraine Property Policy¹ 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 Ukraine², 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 proposals 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.

¹ Ownership Policy of the Joint-Stock company National Joint-Stock Company Naftogaz of Ukraine, <https://zakon.rada.gov.ua/laws/show/982-2020-%D0%BF#n12>

² On Amendments to the Charter of the Joint-Stock Company National Joint-Stock Company Naftogaz of Ukraine, <https://zakon.rada.gov.ua/laws/show/997-2020-%D0%BF>

Report of Naftogaz supervisory board

STRUCTURE OF THE SUPERVISORY BOARD AND ITS COMMITTEES

Changes in the supervisory board

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 Bensch 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 addition to these changes, the initial term of office of Clare Spottiswoode and Bruno Lescoeur, who were elected as supervisory board members by CMU Ordinance No. 892 dated 13 December 2017, concluded on 14 December 2020. However, in accordance with Ordinance No. 1562 dated 14 December 2020, the CMU resolved to extend the term of their office for six months, i.e. until 14 June 2021, by which time relevant additional agreements to extend the term of service agreements would be concluded with them by the company.

The company’s Charter specifies that the supervisory board is composed of seven members, the majority of which will meet the independence criteria. Therefore, as of the end of 2020, incumbent supervisory board members included three government appointees and as many independent directors. Since the termination of Amos Hochstein’s authorities, the fourth independent director’s position has remained vacant, and remains so as at the end of the reporting period and factually as of the date of this Report.

In 2020, independent directors submitted statements (available on the company’s website) confirming that they continue to meet the criteria of independence envisaged by applicable laws of Ukraine for independent directors of business entities in which the state owns more than 50 per cent of shares.

Service agreements and compensation

In the reporting period, service agreements were concluded or continued to be in effect with all supervisory board members pursuant to relevant ordinances of the CMU. Also, CMU Resolution No. 334 dated 29 April 2020 imposed a temporary cap on the monthly remuneration for members of supervisory boards at business companies in the state sector of economy (except for state-owned banks) in the amount of UAH 47,230. This cap was cancelled by CMU Resolution No. 996 dated 26 October 2020.

During 2020, the company incurred UAH 20 million in expenses for the operations of the supervisory board. This amount includes UAH 18 million in service fees and UAH 2 million in compensation for expenses incurred by supervisory board members during performance of their supervisory work, including directors and officers liability insurance procured by the company to cover the liability of these officers after their election, as specified in their service agreements.

No remuneration was paid to Yuliia Kovaliv for the performance of her supervisory board duties in 2020, because she held an office specified in article 3 (1) clause 1 of the Law of Ukraine “On Prevention of Corruption” which she terminated pursuant to Decree of the President of Ukraine No. 580/2020 dated 22 December 2020.

Despite the fact that new government appointee Robert Bensch was contracted by the Minister for Development of Economy, Trade and Agriculture of Ukraine in September 2020, no payments have been discharged to him by the company in absence of the required legal documentation.

Composition of the committees and appointments within the supervisory board

In order to guide the executive board in achieving strategic objectives set forth by the general meeting in the new ownership policy for Naftogaz adopted in October 2020, as well as in formulating and delivering on a long-term corporate strategy, in September 2020, the supervisory board resolved to establish the strategy committee, approved regulations on this committee and its composition, namely: Ludo Van der Heyden as chair of the committee, Clare Spottiswoode, Bruno Lescoeur, Yuliia Kovaliv and Nataliya Boyko as its members.

In addition, following the successful completion of unbundling of its transmission activities on 1 January 2020 and with a view to raising profile of the compliance function within the Naftogaz Group, the supervisory board also decided to rename the ethics and unbundling committee the ethics and compliance committee, and to amend regulations on this committee accordingly.

Given that the responsibilities of Amos Hochstein were terminated in October 2020, the composition of several supervisory board’s committees was affected by changes as well. Each of them should consist of at least three members to be in line with the Law of Ukraine “On Joint Stock Companies” and regulations on corresponding committees. Thus, at the supervisory board meeting held on 12-16 October 2020, Bruno Lescoeur was elected as chair of the nomination and remuneration committee, as he has been successful in running it on a temporary basis a number of times, with Clare Spottiswoode becoming a member of that committee. At the

Supervisory board composition as of the end of 2020					
					
Clare Spottiswoode Chair (independent director)	Yuliia Kovaliv Deputy chair (government appointee)	Bruno Lescoeur Independent director	Ludo Van der Heyden Independent director	Nataliya Boyko Government appointee	Robert Bensch Government appointee

- same meeting, Ludo Van der Heyden was elected as member of the committee on health, safety, environment and reserves, and he subsequently assumed the chairmanship of the said committee.
- Therefore, as of the end of the reporting period, the composition of the supervisory board’s committees was as follows:
- **audit and risks committee:** Bruno Lescoeur – chair of the committee, Clare Spottiswoode and Yuliia Kovaliv – members of the committee;
 - **ethics and compliance committee:** Clare Spottiswoode – chair of the committee, Ludo Van der Heyden and Nataliya Boyko – members of the committee;
 - **nomination and remuneration committee:** Bruno Lescoeur – chair of the committee, Clare Spottiswoode and Ludo Van der Heyden – members of the committee;
 - **committee on health, safety, environment and reserves:** Ludo Van der Heyden – chair of the committee, Bruno Lescoeur and Nataliya Boyko – members of the committee;
 - **strategy committee:** Ludo Van der Heyden – chair of the committee, Clare Spottiswoode, Bruno Lescoeur, Yuliia Kovaliv and Nataliya Boyko – members of the committee.

PROCEEDINGS OF THE SUPERVISORY BOARD AND ITS COMMITTEES

Supervisory board members devoted the time required to perform their duties as provided by the Rules of Procedure of the supervisory board. Members of the supervisory board from time to time notified the corporate secretary of their absence at the meetings, but all regular and extraordinary meetings in 2020 were quorate so as to properly adopt decisions on the agenda items.

In 2020, the company’s supervisory board held 25 meetings (including 16 extraordinary meetings) during which it adopted resolutions on more than 160 items of agenda and considered a significant number of matters submitted for discussion. During the reporting period, the supervisory board continued supervising and regulating the executive board’s operations, all within the supervisory board’s powers as determined by applicable laws, the company’s Charter, and the Rules of Procedure of the supervisory board. At each meeting, the supervisory board was presented with business updates by the chief executive officer and internal audit reports.

The most frequent matters submitted by the executive board for consideration at meetings of the supervisory board 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 concerning 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 annexes/additional agreements thereto, and production sharing agreements for the Buzivska, Berestysanska, Balakliyska, and Ivanivska blocks.

Furthermore, 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 Consolidated Business Plan for 2020-2024 and the revised Naftogaz Group Investment Policy, granting consent for the company to enter into transactions exceeding the thresholds set out by law, including transactions for amendment of loan documentation with state-owned banks, purchase and sale of domestic government bonds, issuance of corporate Eurobonds, entering into a natural gas sales and purchase contract with LLC “GSC “Naftogaz of Ukraine” in order to allow the latter to take part in a tender for the selection of supplier of last resort.

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 Yuzivska.

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. Regrettably, 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 them 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. Given that the new Charter expanded the authorities of the supervisory board, in particular with regard to the approval of internal regulations governing the activities not only of the company but also of the Naftogaz Group, in order to ensure prompt adoption and amending of internal documents within the transformation, in November 2020, the supervisory board delegated authorities to approve internal documents regulating operations of the company and Naftogaz Group, except for those, approval of which by the supervisory board is envisaged by the Law of Ukraine “On Joint Stock Companies” or 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 Audit Policy of 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 new requirements 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 new version of the 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 of corporate governance for shareholders, investors, relevant stakeholders and stock exchange regulators, including in preparation for an initial public offering of minatory stake in the company on a major stock exchange.

Following requirements of clause 70 (30) of the company’s Charter, the supervisory board carried out its self-assessment on the basis of which the annual report of the supervisory board for 2019 was prepared.

In addition, in 2020, supervisory board members held a number of joint transformation and corporate governance sessions with the executive board to discuss, *inter alia*, decision-making by the supervisory board, improvements 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 and, 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 state’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 PJSC “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 maintain permanent liaison 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 in 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 regrettably, 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 is to assist the supervisory board in protection of the company’s interests by preparing drafts and providing recommendations and proposals regarding:
- 1) completeness, accuracy and timeliness of the preparation of the company’s financial statements;
 - 2) effectiveness of the internal accounting and financial controls 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;
 - 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:

Attendance of supervisory board meetings in 2020 (regular and extraordinary)						
	Supervisory board	Audit and risks committee	Ethics and compliance committee	Nomination and remuneration committee	Committee on health, safety, environment and reserves	Strategy committee
Clare Spottiswoode	25/25	14/14	4/4	14/14	3/3	2/2
Yuliia Kovaliv	18/25 with partial presence during meetings on 18-20 February, 16-17 March, 26-27 May, 23-24 June and 1-3 August	9/14 with partial presence during meetings on 19 February and 27 May	2/4	7/14	1/3	0/2
Amos Hochstein	10/20 with partial presence during meetings on 20 January, 18-20 February, 15-16 April, 26-27 May, 23-24 June and 12-16 October	0/12	0/2	6/11 with partial presence during the meeting on 19-20 February	0/2	0/0
Bruno Lescoeur	25/25	14/14	4/4	13/14	3/3	2/2
Ludo Van der Heyden	25/25	13/14	4/4	14/14	3/3	2/2
Nataliya Boyko	25/25 with partial presence during the meeting on 23-24 June	13/14	4/4	13/14	3/3	2/2
Robert Bensch	0/21	0/12	0/4	0/12	0/3	0/2

- 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 compliance and consistency of and any changes to accounting methods and the accounting policy along with how these changes affect the content of the statements, across 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:
 - 1) 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;
 - 2) review the effectiveness of corrective actions taken by the management with respect to improvement of the system of internal control and risk management;
 - 3) 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:
 - 1) 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;
 - 2) control compliance with the Law of Ukraine "On Public Procurement" and other applicable legislation in the selection of the external auditor;
 - 3) control independence and objectivity of the external auditor in line with the Handbook of International Quality Control, Auditing, Review, Other Assurance, and Related Services;
 - 4) 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;
 - 5) 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;
 - 6) 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:
 - 1) submit for approval by the supervisory board the Regulations on the internal audit department;
 - 2) make recommendations to the supervisory board on the appointment, reappointment or removal of the chief audit executive;
 - 3) make recommendations to the supervisory board on the terms of labour agreements which are being concluded with the internal audit department staff (including with the chief audit executive);
 - 4) 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;
 - 5) submit the annual plan of risk-oriented internal audits for approval by the supervisory board;
 - 6) review reports on the activities of the internal audit department;
 - 7) review at least annually the performance and effectiveness of the internal audit department;
 - 8) consider issues that prevent the internal audit department from effective performance of set tasks, and help eliminate such restrictions;
 - 9) ensure sufficient and adequate resources for the effective performance of the internal audit department.
7. To organize and perform the following functions related to treasury arrangements of the company to review and report to the supervisory board on 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 to:
 - 1) initiate and conduct special investigations as needed, including involving independent consultants (experts);
 - 2) consider cases of fraud and assess the adequacy of measures taken by the management to prevent fraud;
 - 3) consider the need for amendments to the Regulations on the committee;
 - 4) provide recommendations on the selection, appointment, reappointment and dismissal of the head of the budgeting unit;
 - 5) 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;
 - 6) 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;
 - 7) perform other duties related to the committee's competence when requested by the supervisory board.

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.

ETHICS AND COMPLIANCE COMMITTEE

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;
- 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:

- 1) ensuring ethical decision-making, compliance with the laws in the jurisdictions in which the company operates as well as conformance with internal company standards;
- 2) fostering of an open culture of reporting underpinned by the company's policies to ensure non-retaliation, conducting investigations and addressing violations.

The committee also organizes and performs the following functions:

- 1) review of the matters included into the agendas of the committee and the supervisory board meetings, and related to corporate ethics, including conflict of interest;
- 2) review and submission of recommendations to the supervisory board regarding situations related to conflict of interest or allegations of ethics-related breaches by supervisory board or executive board members, as well as review and submission of recommendations on other conflict of interest situations or other allegations of ethics-related breaches which are escalated to the committee in the manner established by the internal regulations of the company, and undertaking of internal investigations on any of these matters;
- 3) review and submission of recommendations to the supervisory board re matters of application of the Code of Corporate Ethics if escalated to the supervisory board by the executive board or chief compliance officer in the

manner established by the internal regulations of the company and accepted on supervisory board's agenda by the chair of the supervisory board;

- 4) review and monitoring of conflicts of interest involving executive board or supervisory board members as well as other instances as established by the internal regulations of the company;
- 5) submission of recommendations to the supervisory board on best international practices (general and sector-specific) in terms of corporate ethics, engagement with various stakeholders to assess the adequacy of current company's policies in these areas;
- 6) facilitating the appropriate level of accountability and transparency of the company where this can eliminate or mitigate ethical risks for the company with due account of the data protection requirements;
- 7) facilitating awareness of ethics-related issues with the company's officers and employees, and the efficiency of available means to raise and handle their complaints;
- 8) promotion of effective communication between the company's management and its staff with a view to reinforce understanding of the company's ethical values and encourage their implementation, as well as to deter unacceptable practices;
- 9) providing recommendations to the executive board or chief compliance officer on corporate ethics issues upon their request;
- 10) reporting to the supervisory board on the tasks and functions of the committee performed within the framework of preparing the annual report.

In pursuing its tasks and functions, the committee is entitled to:

- 1) 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;
- 2) initiate and implement appropriate monitoring tools to survey compliance with the Code of Corporate Ethics within the company;
- 3) 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 results of the chief compliance officer;
- 4) 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 internal investigations and audits;
- 5) initiate or conduct internal investigations and audits;
- 6) hold meetings with the company's executives and employees;
- 7) 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;
- 8) facilitate trainings and other similar activities for the company's staff on ethics-related issues;
- 9) have access to reports on alleged ethics-related breaches, oversee subsequent actions by the company's officers in charge;

- 10) review and make recommendations with respect to new projects or activities to be undertaken by the company where such projects or activities may create ethical risks for the company;
- 11) request and receive any relevant information from the company's employees needed for the purposes of investigation of the breaches of company's ethics rules;
- 12) engage independent consultants (experts).

Key results in 2020

In 2020, the ethics and compliance committee held 4 meetings, 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.

NOMINATION AND REMUNERATION COMMITTEE

Key functions of the committee

In line with the current Regulations on the nomination and remuneration committee of the supervisory board, the key tasks of this committee are as follows:

1. Assist the supervisory board in preparing draft:
 - 1) succession strategy of the company's supervisory board, executive board and other officials (if applicable pursuant to the Charter or internal regulations of the company) that includes, in particular, search of potential nominees for the position of the chief executive officer in case of termination of authorities of the current chief executive officer, in order to ensure continuity of the executive board;
 - 2) policies and standards of the company on selection of nominees for the positions of the chief executive officer and members of the executive board, other officers of the company nominated and dismissed by the supervisory board, aimed at engagement of qualified specialists in the management of the company;
 - 3) principles for defining remuneration for the chief executive officer and members of the executive board in order to create necessary incentives for the efficient work in implementation of the company's development strategy;
 - 4) terms of employment agreements (contracts) to be concluded with the chief executive officer and members of the executive board, other officers of the company nominated and dismissed by the supervisory board.
2. Submission to the general meeting or the supervisory board (as established by the Charter) of recommendations and proposals on:
 - 1) candidates for the positions of the chief executive officer and members of the executive board, other officers of the company nominated and dismissed by the supervisory board;
 - 2) termination of authorities of the chief executive officer and members of the executive board;
 - 3) engagement of independent external adviser for assessment of the supervisory board members' work;
 - 4) candidates for the positions of supervisory board members.

3. In accordance with the tasks, the committee performs the following functions:
 - 1) development and periodic review of the company's policies (internal regulations) on nomination and remuneration;
 - 2) preliminary review of the matters related to the nomination and remuneration of the chief executive officer and members of the executive board, as well as other officials (if applicable pursuant to the Charter or internal regulations of the company);
 - 3) organization of drafting and processing of draft policies, strategies, rules of procedure, resolutions and other documents that regulate the activity in the area of nominations and remunerations of the chief executive officer and members of the executive board, preparing conclusions, recommendations, proposals for the supervisory board;
 - 4) analysis of current and expected needs of the company in professional qualification of the chief executive officer and members of the executive board, other officers of the company nominated and dismissed by the supervisory board, based on the company's interests and development strategy, defining the eligibility criteria for nomination of candidates;
 - 5) determination and ensuring selection procedures, nomination of candidates and recommendation for approval by the general meeting or the supervisory board (as defined by the Charter) of candidates for vacancies in the supervisory board, the executive board or other officers of the company nominated and dismissed by the supervisory board;
 - 6) preparation and submission for review by the general meeting or the supervisory board (as established by the Charter) of proposals regarding election or termination of authorities of the chief executive officer and members of the executive board, other officers of the company nominated and dismissed by the supervisory board;
 - 7) making comparative analysis and informing the supervisory board of the policies, programs, international practice, situation in the labour market regarding levels and systems of remuneration for members of executive bodies of business entities, proposals for remuneration of the chief executive officer and members of the executive board;
 - 8) submitting proposals to the supervisory board concerning individual remuneration for members of the executive board, ensuring their compatibility with the remuneration policy adopted by the company and compliance with the assessment of the performance of the member of the executive board who is individually remunerated;
 - 9) organization of development, processing, making recommendations regarding forms and essential terms of labour agreements (contracts) to be concluded with the chief executive officer and members of the executive board;
 - 10) forming proposals regarding key performance indicators and organization of procedures of their periodic assessment for the chief executive officer and members of the executive board, corporate secretary, chief risk officer, chief audit executive, chief compliance officer, anticorruption officer;
 - 11) periodic assessment of the structure, size, composition and performance of the executive board and provision of recommendations for any changes;

- 12) periodic assessment of the chief executive officer and members of the executive board for conformity with qualification requirements and relevant reporting to the supervisory board;
- 13) development of the succession plans for the chair and members of the supervisory board;
- 14) development of the succession plans for the executive board, ensuring that the executive board has an appropriate succession plan for the company's executives;
- 15) advising the supervisory board on the composition of its committees and periodic rotation of committees' members;
- 16) ensuring training programs for members of the supervisory board and the executive board required for their efficient performance in the corporate governance framework implemented by the company;
- 17) preliminary analysis of performance results of the chief executive officer and members of the executive board, including in view of possible remuneration increase, application of other incentives;
- 18) monitoring of the supervisory board resolutions' implementation within the committee's authority;
- 19) approving nomination of the company's executives at their appointment;
- 20) controlling the level and structure of remuneration of the company's executives, provision of general recommendations to the executive board on these issues;
- 21) making an annual report to the supervisory board on the activity of the committee including information on the composition, number of meetings and main activities of the committee, and also, upon supervisory board's demand, regular reports or information on certain matters of the committee's activity.

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 10 matters that were submitted for discussion. The committee considers that all its action in 2020 has helped ensure the continuity of management required at a time when the company needs to continue and accelerate its reform.

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 of the items with regard to exercise of the control over:
 - 1) strategy for health, safety and environment (the "HSE"), and evaluation and management of hydrocarbon resources and reserves (the "Reserves"), 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

- to support 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 (accident situation) response plan;
 - 4) scope and outcomes of social investment programs and social development partnerships;
 - 5) evaluation 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;
 - 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 committee on health, safety, environment and reserves held 3 meetings, adopted 1 resolution on an agenda item, and considered more than 5 matters that were submitted for discussion. Smooth operation and protection of employees across the Naftogaz Group in times of the global COVID-19 crisis as 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 Naftogaz Group and the executive board;
 - 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;

- 5) providing guidance and advice to the supervisory board and the Executive Board on matters within the scope of the committee’s tasks;
- 6) supporting and facilitating effective dialogue with stakeholders regarding the Naftogaz Group Corporate Strategy and transformation.

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 Group, 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, dispositions 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.

Executive board members



Andriy Kobolyev
Chief executive officer since 25 March 2014



Sergiy Pereloma
First deputy chief executive officer since August 2014



Otto Waterlander
Chief operating officer of Naftogaz Group, Naftogaz Group chief transformation officer, executive board member since 21 January 2020



Petrus Stephanus van Driel
Chief Financial Officer of Naftogaz Group, executive board member since 21 January 2020



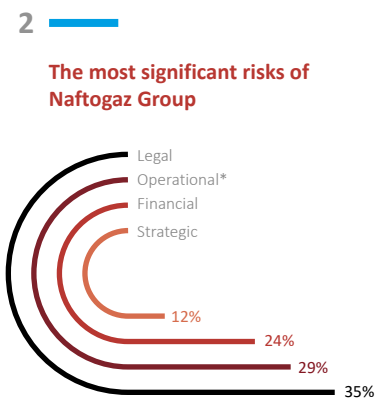
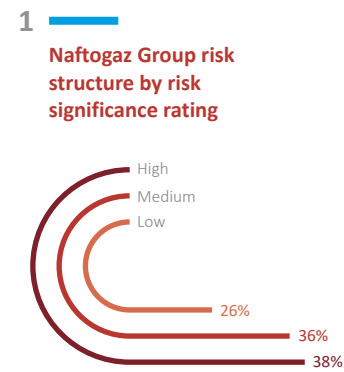
Yaroslav Teklyuk
Director for legal affairs, executive board member since 21 January 2020

In 2020, the management team included 5 executive board members and 12 directors (5 executive board members and 11 directors in 2019)

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



*Operational risk including environmental, health and safety risks

In 2020, Naftogaz Group made significant changes to its company risk assessment procedure. The updated procedure revealed the following major risks:

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 gas 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 (oblgazzbut) and district heating providers (DHP) due to the extension of the Regulation on Assigning Special Obligations (PSO)

During 2020, the Regulation on Assigning Special Obligations to Naftogaz of Ukraine NJSC 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 shareholder 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 hydrocarbon reserves replacement

Most of the existing deposits where the Group operates are highly depleted (70-80%), which leads to a constant decline in hydrocarbon 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 Luhansk 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. Illegal 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 mode), 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.

In order to mitigate risk, the Group decided to open 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.

Obsolete equipment in the enterprises of the Group also creates a significant threat to the health and lives of workers. For this reason, Naftogaz Group makes regular investments in existing production facilities diagnostics and upgrading.

LEGAL RISKS

Lawsuits against Naftogaz Group companies initiated by regional gas distribution companies

During 2020, a number of contradictory judgments were made on lawsuits against the Group initiated by some regional gas distribution companies. The judgments delivered by the courts were on the resumption of gas supply and granting the right to consume gas from the Group's resources, recognition of over-payment for consumed gas, and other issues. The total risk from such lawsuits in 2020 exceeded UAH 10 billion.

In order to protect its interests, the Group is building up an effective system of legal protection in the courts and ensures strict compliance with the law and fulfillment of conditions under contracts with contractors.

Compensation

UAH 32.2 billion

received the Group for the sale of imported gas for needs of households at the end of 2020



5. CORPORATE SOCIAL RESPONSIBILITY

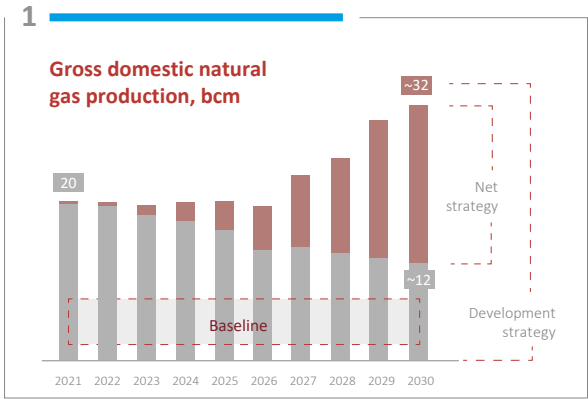
164 | Local community development
170 | Environmental protection
178 | Energy efficiency

DEVELOPMENT STRATEGY LESS BASELINE
ENABLES ARRIVAL AT NET STRATEGY EFFECTS

Baseline:
O&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 debits; 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)

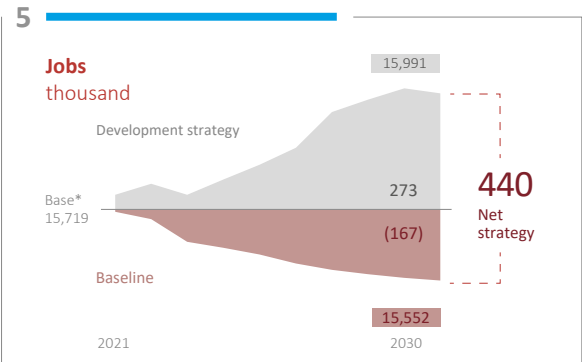
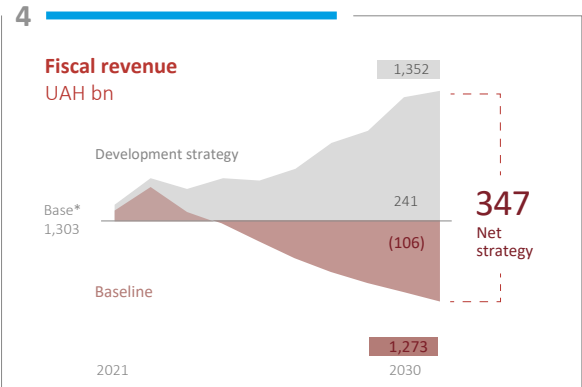
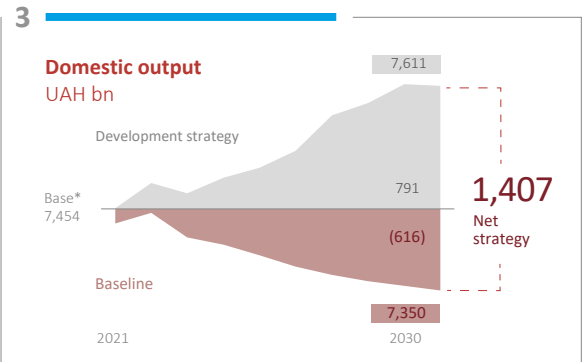
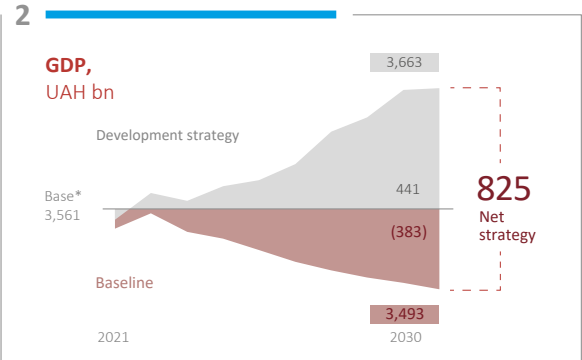
Net strategy:
development projects for new fields



Development strategy:
energy independence by 2030

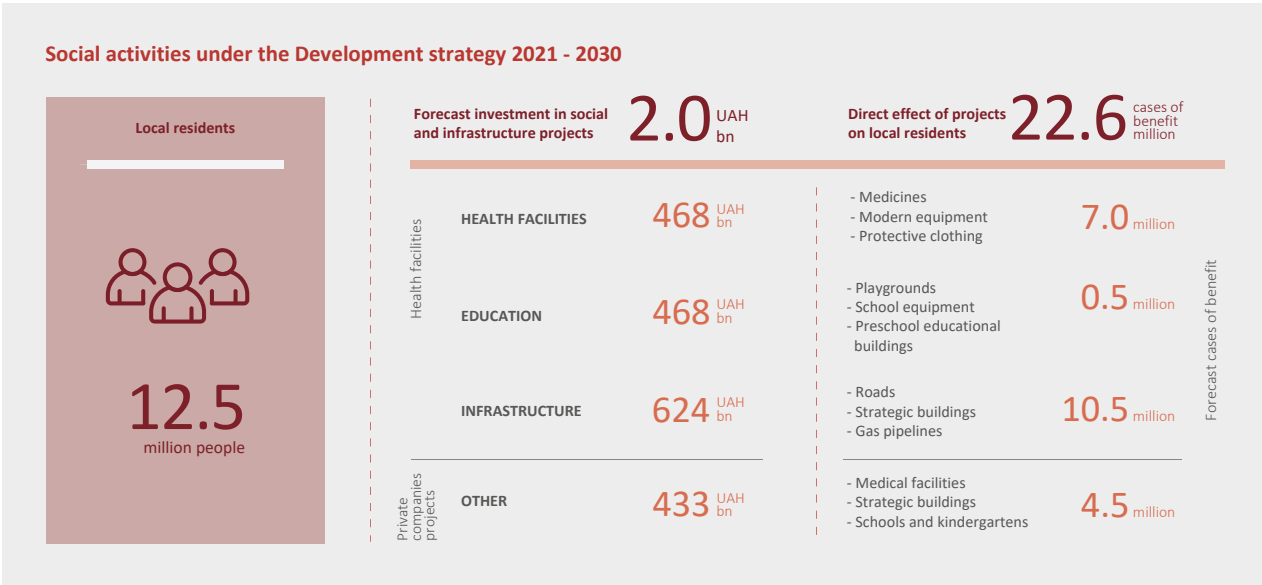
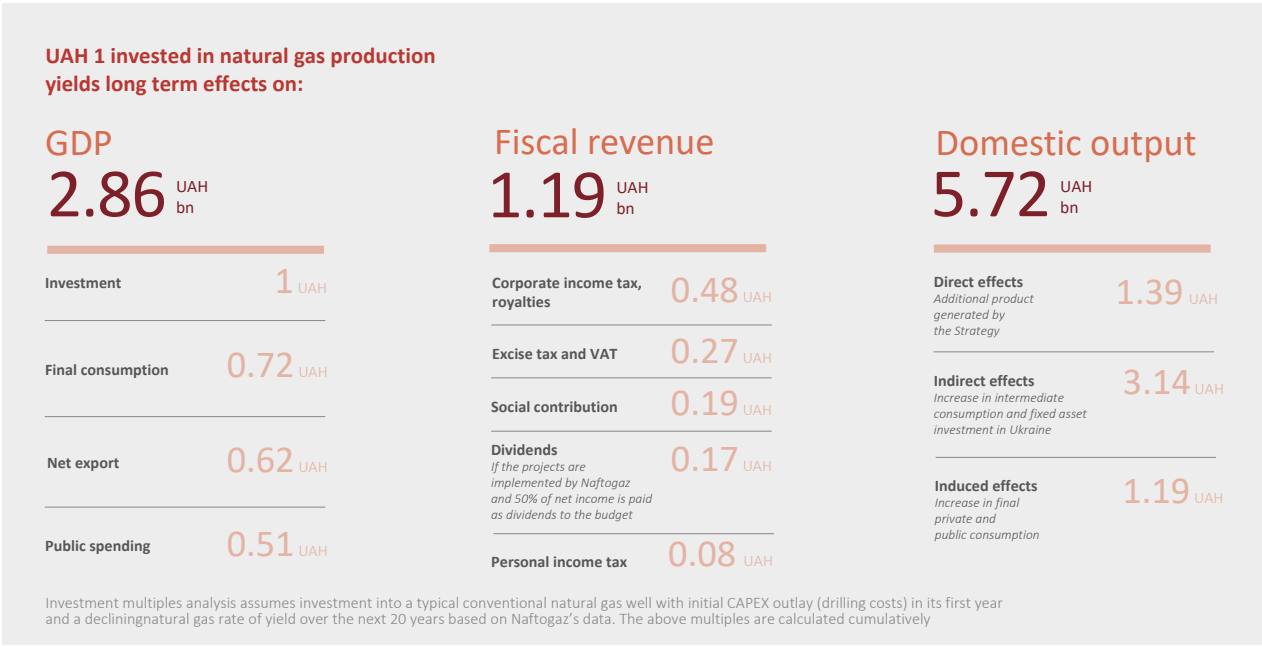
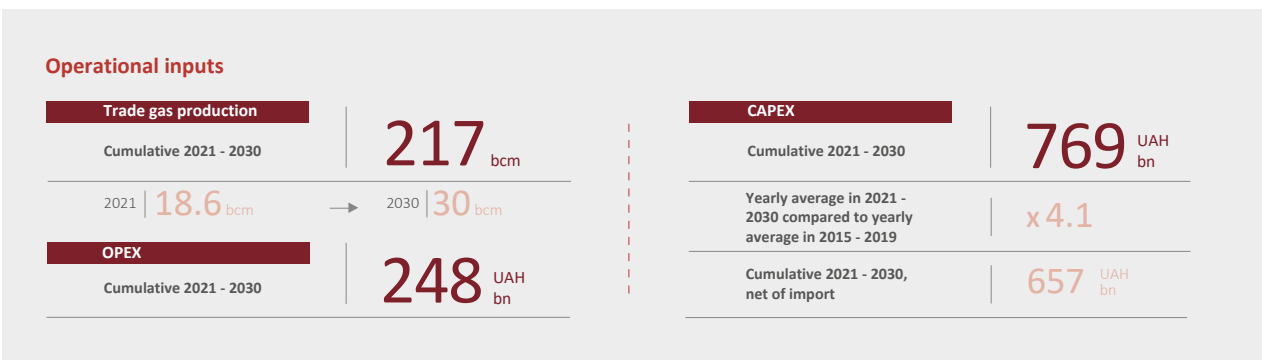
- Implementation, along with baseline operation, of a complex of projects, which may result in gradual natural gas import substitution in Ukraine from 2021 to 2030
- The energy independence strategy may be implemented either by Naftogaz or conjunction with private market participants (the effects may vary depending on CAPEX efficiency, sequence of projects etc.)

CUMULATIVE EFFECTS
2021 - 2030



* Base values are accepted at the level of 2018, as of the most recent year for which Input Output table is available as per Ukrstat Numbers may not add up due to rounding.

DEVELOPMENT STRATEGY LEADS
TO ENERGY INDEPENDENCE

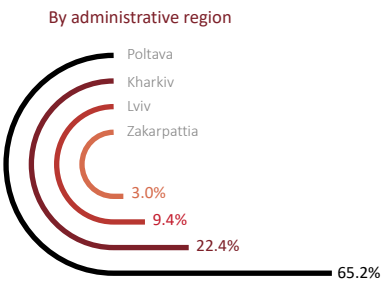
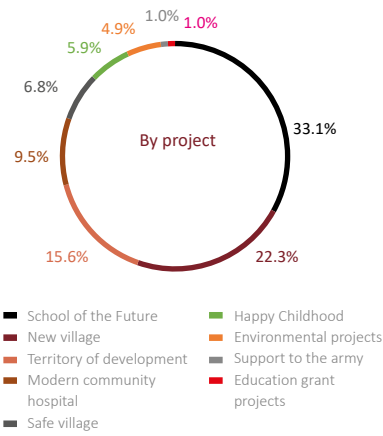


Local community development

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.

1 Investments made by Naftogaz Group in social and infrastructure projects and charitable assistance in 2020

UAH 21 million investments in social and infrastructure projects in 2020



¹ Ukrgasvydobuvannya JSC corporate social responsibility standard in relations with communities, charitable organizations and NGOs, https://ugv.com.ua/uploads/Standart_korporatyvnoi_soc%D1%96alnoi_v%D1%96dpov%D1%96dalnost%D1%96_479_v%D1%96d_06082020.pdf

² The feedback form for Ukrgasvydobuvannya projects in the regions is available at: <https://ugv.com.ua/uk/page/dla-zvernenn>

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:



Goal No 3: Good health and well-being
Protect life and health of the community, support to health care institutions



Goal No 4: Quality education
Provide and maintain quality education



Goal No 11: Sustainable cities and communities
Support for the development of community culture, leisure, spiritual resurgence and safe, comfortable living conditions

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 and the Corporate Social Responsibility Standard for Relations with Communities, Charitable Organizations and NGOs¹ 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 Department². The Regional Development Department 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, Ukrgasvydobuvannya initiated the process of publishing reports on the social and economic impact of Ukrgasvydobuvannya's operations in the National Unified EIA Register. In 2020, Ukrgasvydobuvannya 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, Ukrgasvydobuvannya, 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

2

Key social infrastructure projects implemented by Naftogaz Group in 2020



UAH 2 million investments in healthcare and support to medical institutions projects

Modern Community Hospital Project

UAH 2 million – investments in 2020
UAH 5 million – investments in 2017-2020

The purpose of the project is to provide comfortable working conditions for healthcare staff and improve the level of healthcare services in local communities.

In 2020, funds were allocated to purchase of medical equipment for Poltava region healthcare institutions in the village of Tsipky in Hadiach district, and the village of Pyshnenky in Zinkiv district. The district hospital in the village of Martynivka, Karlivka district, was rebuilt and the working conditions in the healthcare facility in the village of Vodyana Blaka, Dykanka district, Poltava region were improved.



UAH 7 million investments in projects aimed at providing quality education

School of the Future Project

UAH 7 million – investments in 2020
UAH 23 million – investments in 2017-2020

The purpose of the project is to provide comfortable modern conditions for the education of children and teachers in local communities. The project purchased state-of-the-art equipment and functional furniture for schools in Ukraine. It equipped modern classrooms, undertook repairs, and reconstructed educational institutions, while upgrading school heating systems.

Thanks to the Project, a state-of-the-art physics classroom is now available in the school of Komyshehna village, Myrhorod district, Poltava region. In 2018, jointly with the BroBots Technical Development Center, two modern robotics training studios were opened in schools in Donetsk, Balakliia district, and the town of Krasnograd, Krasnograd district, Kharkiv region, which the Company continues to systematically support.

In partnership with the Association of Ukrainian Marketing Professionals NGO, organized a competition «My project for the community». Schoolchildren presented their project ideas addressing social problems in their communities. As part of the project, representatives of 24 secondary schools from Poltava, Kharkiv, Lviv, Ivano-Frankivsk and Volyn regions got acquainted with the company's sustainable development and corporate social responsibility principles, social and production activities.

Educational grant projects

UAH 0.2 million – investments in 2020



UAH 12 million investments in the cities and communities sustainable development projects and environmental projects

New Village Project

UAH 5 million – investments in 2020
UAH 211 million – investments in 2015-2020

The purpose of the project is to create comfortable living conditions in the community.

The project purchased multi-functional equipment for the provision of amenities and landscaping in communities, and repaired and upgraded water supply systems in settlements where the company operates.

Development Territory Project

UAH 3 million – investments in 2020
UAH 6 million – investments in 2017-2020

The project aims to create sustainable conditions for culture, sports and education in local communities through upgrading and creating the required infrastructure.

Investments in the construction and repair of gyms and playgrounds, libraries, and cultural centers in the locations of the company's commercial operations.

Safe Village Project

UAH 1 million – investments in 2020
UAH 4 million – investments in 2017-2020

The purpose of the project is to ensure comfortable and safe living conditions in local communities.

The company invested in the installation of street lighting, the purchase of energy-saving lights and LED lights with solar panels, and video surveillance systems in the locations of its commercial operations.

Happy Childhood Project

UAH 1 million – investments in 2020
UAH 2 million – investments in 2017-2020

The project is designed to provide comfortable conditions for leisure for children in local communities.

Thanks to this project implemented by the company, new play areas for children, and playrooms in preschool educational institutions were built in settlements where the company operates.

CSR projects for regional development



GOOD HEALTH AND WELL-BEING

Providing the outpatient clinic with basic office equipment

Pyshnenky village, Zinkiv district, Poltava region



Modern hospital to communities



Modern hospital to communities

Upgrading the local hospital

Martynivka village, Karlivka district, Poltava region



Modern hospital to communities

Creating comfortable environment for medical staff

Vodiana Blaka village, Dykanka district, Poltava region



Modern hospital to communities

Buying a new ECG machine for the rural medical post

Tsipky village, Hadiach district, Poltava region



Modern hospital to communities

Buying oxygen equipment for the Myrhorod central district hospital



Modern hospital to communities

Major repair of the rural medical post

Holovach village, Poltava district, Poltava region



RESPONSE TO COVID-19

287 hospitals
19 regions of Ukraine
500 thousand protective suits
700 patient monitors
50 mobile digital x-ray machines
50 mobile ultrasound machines



Mriya



Assistance to hospitals

19 hospitals in Kyiv and Cherkasy received:
42 thousand masks
90 thousand respirators
1000 l of disinfectants

In partnership with the Education Ministry, delivered to all regional education departments in Ukraine:
3.2 million medical masks
> 20 thousand liters of disinfectants and
1 200 medical overalls



Safe external independent testing



49 lung ventilators

49 lung ventilators repaired and delivered to 39 hospitals in 14 regions of Ukraine

236 communities and rural medical posts, 60 central district hospitals received:
> 1 million pairs of protective gloves,
> 500 thousand medical masks,
> 220 thousand respirators,
920 non-contact infrared,
> 4000 l of disinfectants



Assistance to communities



Modern hospital to communities

Helped deliver medical supplies to 11 central district hospitals in Poltava, Kharkiv, and Lviv regions



QUALITY EDUCATION

Equipping the secondary school

Kolontaiv village, Krasnokutsk district, Kharkiv region



School of future



School of future

Equipping the state-of-the-art physics classroom

Komyshnia town, Myrhorod district, Poltava region



School of future

Major repair of the dining facility in the secondary school

Lanna village, Karlivka district, Poltava region



School of future

Equipped physics and IT classrooms

Bilsk village, Kotelva district, Poltava region

Multimedia equipment for the history classroom in the secondary school

Pyshnenky village, Zinkiv district, Poltava region



School of future



School of future

Major repair of toilets in the secondary school, purchase of sport equipment

Voroblevychi village, Drohobych district, Lviv region



SUSTAINABLE CITIES AND COMMUNITIES

Equipping the Myloradove community center

Myloradove village, Kotelva district, Poltava region



Territory of Development



Territory of Development

Equipping the gym

Krasna Luka village, Hadiach district, Poltava region



Territory of Development

Reroofing the leisure center

Roiakivka village, Kehychivka district, Kharkiv region



Territory of Development

Creating the leisure center on the basis of the community hall

Orkhovychi village, Sambir district, Lviv region



Happy childhood

Construction of playgrounds

Kehychivka town, Kehychivka district, Kharkiv region



New village

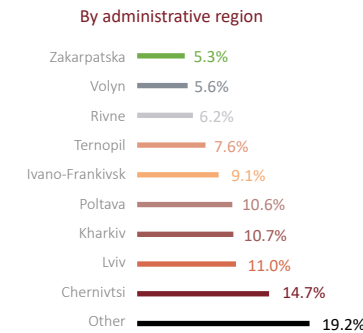
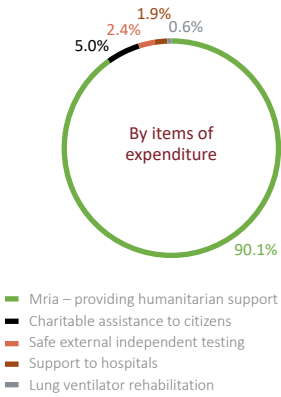
Providing households with high quality drinking water

Tsipky village, Hadiach district, Poltava region

3

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



Naftogaz Group has launched a web page <https://csr.ugv.com.ua/> to increase transparency and public accountability on relations with communities, social investment and paying taxes to local budgets

<https://csr.ugv.com.ua/>



amounted to UAH 0.18 million. To effectively meet the needs of local communities, Naftogaz Group involves partners in the implementation of its social infrastructure projects:

- Reconstruction and equipment of a gym in the village of Krasna Luka, Poltava region, in partnership with the KERNEL group of companies
- Support for an educational and cultural center in the village of Orkhovychi and the village of Voroblevychi, Lviv region, in cooperation with the MHP Group of Companies

Naftogaz Group jointly with the MHP Group of companies in cooperation with the Future for the Community Charitable Foundation implemented 3 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 Voroblevychi were refurbished and the building of the People’s House in the village of Orkhovychi was reconstructed.

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, Ukrasvydobuvannya 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:

- Mria (Dream) project – Ukrasvydobuvannya, in partnership with the Ministry of Health of Ukraine, provided humanitarian aid to 287 hospitals in 19 regions of Ukraine. In particular, 500,000 protective suits, 700 patient monitors, 50 mobile digital X-ray machines, and 50 portable ultrasound devices were purchased;
- repair of lung ventilators – 49 ventilators in 39 hospitals across 14 regions of Ukraine were repaired with financial support from the company;
- support to hospitals – the project purchased and transferred medical equipment, personal protective equipment, and essential medicines to 33 central district and city hospitals in Poltava, Kharkiv, Lviv regions as well as Kyiv and Cherkasy;
- safe external independent testing – 24 regional and Kyiv city departments of education and science were provided with personal protective equipment and disinfectants to guarantee a safe university admissions process. 3.2 million medical masks, more than 20,000 liters of disinfectants, and 1,200 insulating gowns were purchased;
- charitable support to communities – 236 communities in 11 regions of Ukraine, 60 central districts and city hospitals, district primary healthcare centers, and local outpatient clinics were provided with disinfectants and protective equipment: almost 400 liters of disinfectants, more than 1 million pairs of protective gloves, more than 0.5 million medical masks, more than 220 thousand respirators, 920 infrared contactless thermometers and more;
- the procurement department spent UAH 50 million on 10 000 oxygen cylinders for lung ventilators.

The charitable assistance provided by Ukrnafta to local communities in 2020 reached a total of UAH 2.6 million. UAH 227.5 thousand was provided to Ukrvaksina SE reporting to the Ministry of Health of Ukraine. As a result, 14,000 liters of fuel were provided for the transportation 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 Rozhniativ central district hospital.

Besides that, in May-June 2020, Naftogaz gas production units Okhtyrkanaftogaz, Poltavanaftoaz and Chernihvnaftogaz delivered 3 tons of food supplies to the regional specialized hospital in Sumy, central district hospitals in Okhtyrka, Hadiach, Varva and Pryluky, 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.

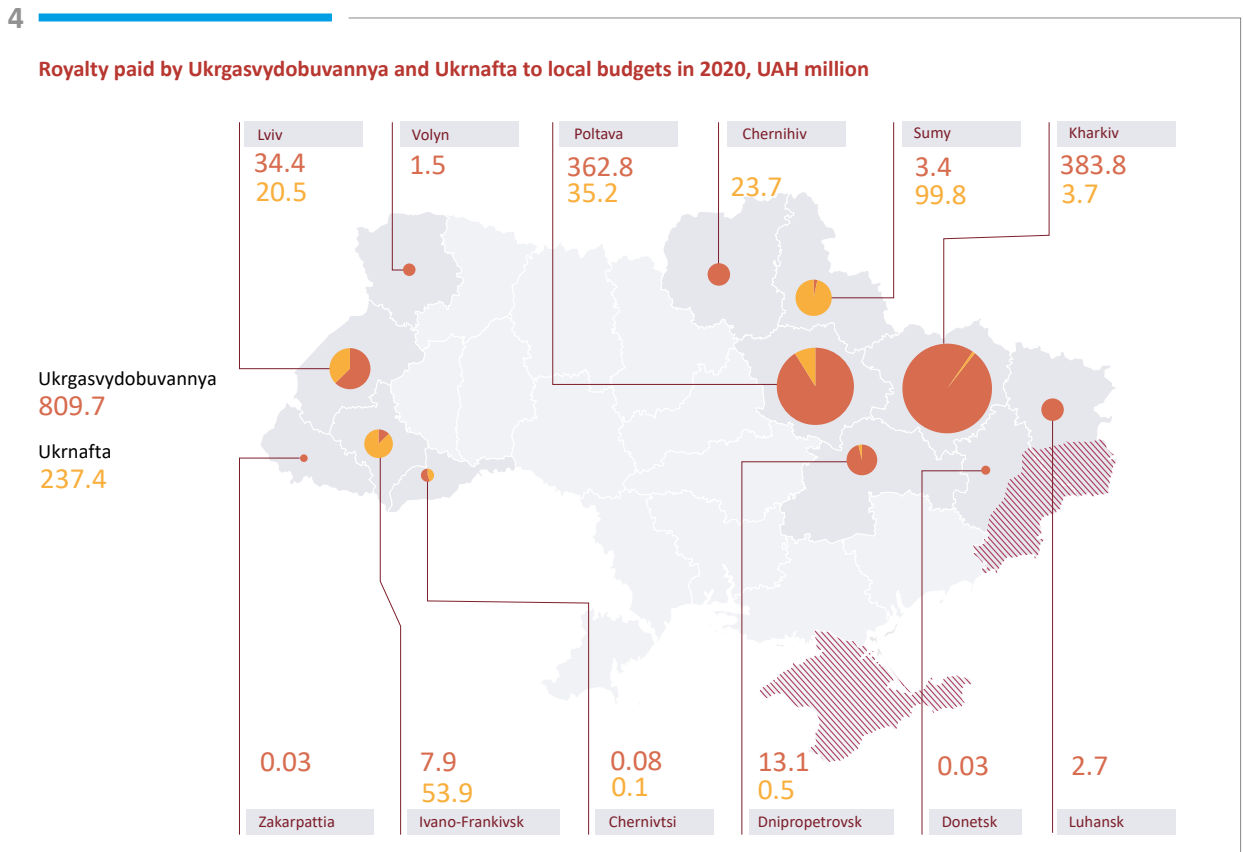
Royalty

In 2020, Ukrasvydobuvannya paid UAH 14.0 billion in royalty to the Ukrainian state budget. According to current Ukrainian legislation, 5% of royalty is transferred to local budgets. Local budgets in 11 administrative regions of Ukraine therefore received UAH 809.7 million of royalty.

Ukrnafta paid UAH 4.8 billion in royalty (royalty for 12 months 2020) to the state budget in 2020. UAH 237.4 million was transferred to the budgets of 8 Ukrainian regions. Local communities used the funds to finance social infrastructure projects.

PLANS FOR 2021

- Implement more than 130 social infrastructure and charitable projects and two national education grant projects in local communities.
- Implement the Energy of Development project in partnership with the Institute of Partnership and Sustainable Development NGO. The key focus of the project is a national educational competition to support social initiatives in the communities where Naftogaz Group operates (240 communities). The project will create a supportive environment for further sustainable development in these regions. Based on the results of the competition, 50 finalists will each receive UAH 100,000 grants.



Environmental protection

Naftogaz Group environmental protection activities are regulated by the Environmental Safety Policy approved in 2020. The provisions of this Policy stipulate that the Group fulfils its obligations to:

- 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 by the following programs and plans in 2020:

- Goals in environmental protection and actions to achieve them;
- Naftogaz Comprehensive Environmental Action Plan for 2015-2020;
- Environmental and Social Action Plan developed under a loan agreement with the International Bank for Reconstruction and Development;
- 2015-2020 Energy Efficiency Improvement Program of National Joint Stock Company “Naftogaz of Ukraine”.

Naftogaz Group puts significant effort into preventing and mitigating any adverse impact from its operational processes on the natural environment. The Company’s entities monitor greenhouse gas and other emissions while seeking to improve energy efficiency and waste management practices. The Company makes annual investments into environmental protection actions, including re-soiling, waste water treatment, and preserving biodiversity.

ENVIRONMENTAL PROTECTION MANAGEMENT

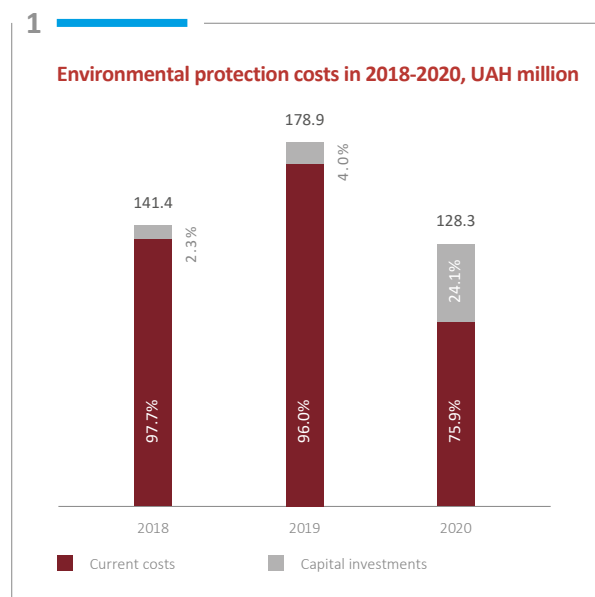
Naftogaz Group conducts regular internal environmental audits at its entities in order to support and improve the efficiency of environmental management systems. These actions are carried out in compliance with international standards ISO 14001:2015¹, ISO 19011:2018² and SOU 71.2-20077720-079:2017 “Environmental protection. Environmental Audit in National Joint Stock Company “Naftogaz of Ukraine”. Main Provisions”. During 2020, corporate auditors conducted 2 environmental audits of operations conducted by branches and production units, namely: branch BMF Ukgazprombud (construction and erection firm) of JSC Ukrtransgaz, and Poltava VBR (drilling works section) of branch BU

Ukrburgaz (drilling division) of JSC Ukgasvydobuvannya. Following these audits, proposals and recommendations were developed to eliminate any identified gaps. Implementation of these recommendations remains under continuous monitoring.

The company maintains an environmental working group tasked with matters of environmental safety and drafting optimization proposals related to production processes and the company’s activities in general. The working group includes representatives of Naftogaz HQ and environmental offices of the Naftogaz Group entities.

Naftogaz Group has a hotline where concerned persons have the opportunity to complain or make suggestions regarding the company’s practices in terms of environmental protection, occupational safety, and social protection. Based on the company’s unified monitoring system, an automated process has been introduced to transmit urgent messages on incidents at Naftogaz Group sites.

Employees across Naftogaz Group are continuously improving their practical and theoretical knowledge of global best practices in environmental management, environmental audit of the



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:

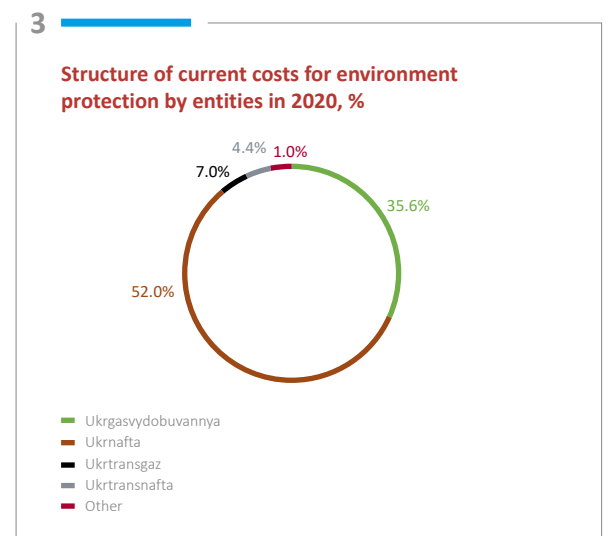
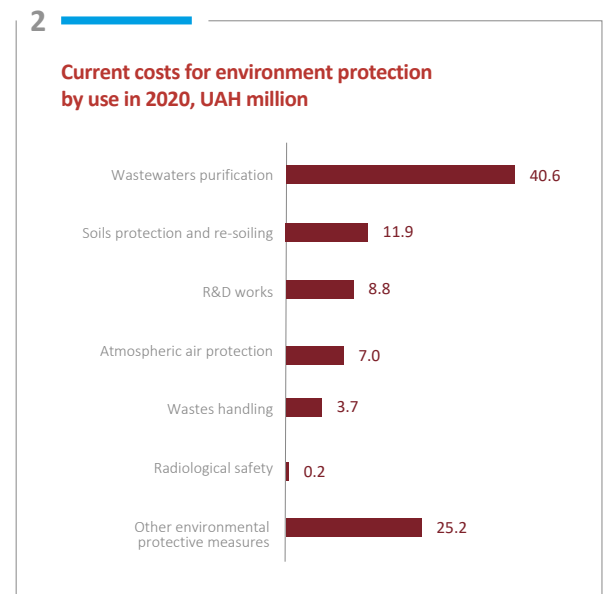
- Workshop “Management System Audit in compliance with ISO 14001:2015, ISO 45001:2018, ISO 50001:2018. Internal audits and leading auditors. Best practices”;
- Workshop “Management Systems in compliance with ISO 14001, ISO 45001, ISO 50001. Corporate governance system. Experience of vertically-integrated companies. Performance assessment, main elements of governance system. Improvement of governance system deliverables. Best practices. Performance assessment indicators”;
- Training “Non-financial reporting per GRI standards. Monitoring reporting and verification (MRV) of greenhouse gas emissions”.

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 71.2-20077720-079:2017 “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). In 2020, a search for methane leaks and measurement of volumes throughout the technological equipment of Ukgasvydobuvannya and Ukrtransgaz was organized jointly with the Norwegian company Carbon Limits. Measurements were carried out in winter at a time of significant load on the system and higher rate of gas withdrawal from underground storage facilities, as well as at higher pressures of process equipment. The task required the use of unmanned aerial vehicles, an infrared camera to search for methane leaks, and ground mobile crews to carry out measurements. This work resulted in recommendations on actions to be taken to reduce methane emissions in natural gas supply

chains, a decision was made to develop a Process Equipment Replacement Roadmap and Investment Program, the implementation of which will reduce methane leaks across Group entities.

- (5) 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.
- (6) Laboratories of Ukrtransgaz, Ukrnafta and Ukgasvydobuvannya conducted cross-check measurements of actual NOx and CO concentrations (mg/m³) and mass emission (g/h) under



¹ ISO 14001:2015 “Environmental management systems. Requirements with guidance for use”
² ISO 19011:2018 “Guidelines for auditing management systems”

standard conditions³, 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/EC “On industrial emissions (integrated pollution prevention and control)” and Directive (EU) 2015/2193 “On the limitation of emissions 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.

- (7) 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 at oil and gas collection facilities.

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 current costs (UAH 97.4 m) and 24.1% into capital investments (UAH 30.9 m). **1**

Most capital investments were directed into soil protection and re-soiling financed by Ukrnafta with UAH 30.7 m. Ukrnafta expended the majority of current costs for environmental protection activities totalling UAH 50.6 m or 52.0% of cumulative current costs of Naftogaz Group.

Structure of pollutant emissions into the atmospheric air by Naftogaz Group in 2020

Entity	Pollutant emissions, kt	Including, kt:				
		Carbon monoxide (CO)	Dioxide (SO ₂) and other sulphur compounds	Nitrogen compounds (NO _x), without N ₂ O	Non-methane volatile organic compounds	Substances in the form of suspended solid particles (micro-particles and fibres)
Ukrasvydobuvannya	12.8	6.6	0.16	4.1	1.6	0.4
Ukrnafta	14.4	6.4	0.02	2.5	4.9	0.6
Ukrtransgaz	1.7	1.1	0.001	0.6	0.03	0.01
Ukrtransnafta	1.8	0.0	0.0002	0.004	1.8	0.001
Other	0.3	0.2	0.0	0.1	0.004	0.001
Total	31.0	14.3	0.2	7.3	8.2	1.0

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 wastes handling, and 0.2% for radiation 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 25.2 m on this group of measures.

During 2020, Naftogaz Group had 8 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. **2 3**

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 Ukrgasvydobuvannya. By tax categories, the largest payment by Naftogaz Group was exercised for pollutant emissions from fixed sources, equalling 90.0% of the total amount. Draft estimates of environmental tax for pollutant emissions is prepared quarterly by the Environmental and Radiological Safety Section based on an Inventory Report on pollutant emissions and Permit for pollutant emissions⁴. Afterwards, it is submitted to the Accounting and Reporting Department and LLC “Naftogaz Digital Technologies”, which is responsible for preparation and submission of environmental tax returns. **4**

Another environmental cost category of the company in the reporting period was payment for services intended for nature protection purposes, namely services on wastewater disposal and purification, as well as waste handling, amounting to UAH 33.3 m. At the same time, the proceeds from the company’s provision of environmental protection services amounted to UAH 71.6⁵ thousand and UAH 136.1 m from waste sales.

ENVIRONMENTAL POLLUTION CASES IN 2020

Substantial risks of industrial environmental pollution are caused by unauthorised 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 8,342.5 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 Skhidno-Rohyntsivske field of PJSC UKRNAFTA due to the breakage of a polished rod. The company informed the land owner and liquidated the accident aftermath.

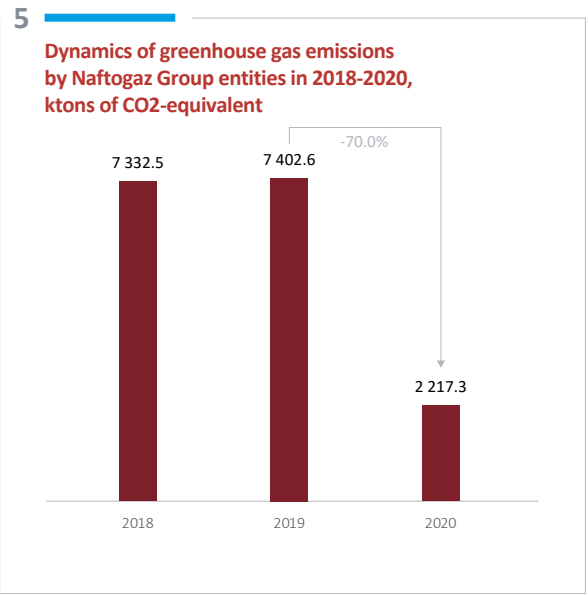
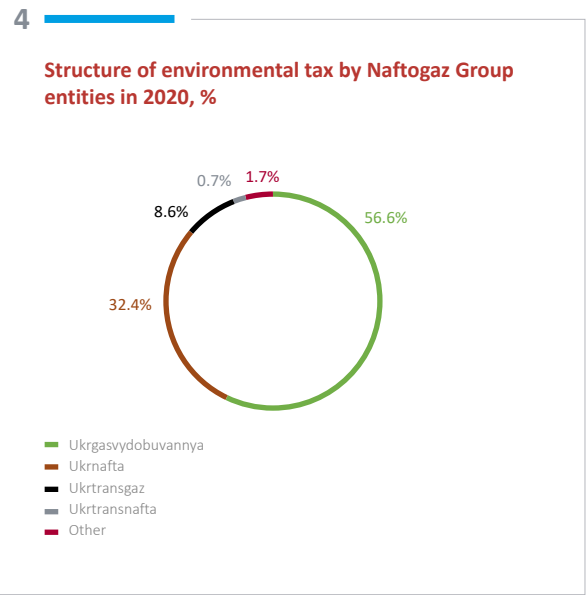
MITIGATION OF IMPACT ON ATMOSPHERIC AIR

Reduction of pollutant emissions

Pollutant 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 39.0% lower than 2019.

Structure of greenhouse gas emissions into the atmospheric air by Naftogaz Group in 2020

Entity	Emissions of greenhouse gases, kt CO ₂ -equiv.	including, kt CO ₂ -equiv.		
		Carbon dioxide (CO ₂)	Nitrogen oxide (N ₂ O)	Methane (CH ₄)
Ukrasvydobuvannya	1 298.8	1 048.5	5.3	243.6
Ukrnafta	593.7	452.1	8.0	134.4
Ukrtransgaz	251.4	170.6	1.9	78.4
Ukrtransnafta	3.7	1.7	0.03	2.8
Other	69.7	53.4	0.03	16.8
Total	2 217.3	1 726.3	15.2	476.0



³ Normal conditions- temperature 273 K, pressure 101.3 kPa

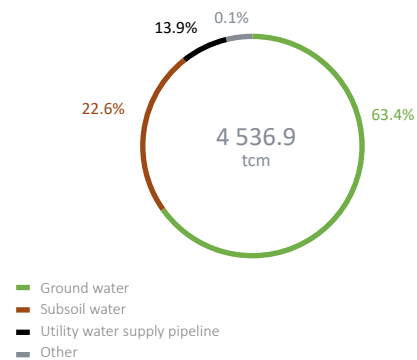
⁴ Permission for emissions of pollutants into the atmosphere by stationary sources from 04/23/2019 No 8039100000-10298. The permission covers stationary sources of the administrative building, which is located in Kyiv, on the B. Khmelnytsky Street, 6. The validity of the permission is unlimited, as the object is referred to the third group of stationary sources.
⁵ According to the mandate of the State Statistics Committee dated 23.12.2019 No 435 and in accordance with the Clarification on the indicators of the form of statistical observation dated 21.08.2020, the receipt of funds from the provision of environmental services in 2020 included wastewater disposal and treatment services, as well as waste management. In 2019, these services included: return water treatment measures, soil protection and rehabilitation, environmental research.

Within the fulfilment of the Comprehensive Environmental Action Plan of Naftogaz Group for 2015-2020, the company took a range of measures to ensure the reduction of greenhouse gas emissions:

- modernisation and optimisation of technological modes of existing fuel-consuming and other equipment;
- obtaining permits for pollutant emissions into the atmospheric air and execution of specific terms of permits;
- detection by mobile laboratories of leaks from shut-off valves and their elimination with the help of modern equipment and high-performance sealing materials;
- reduction of blowdowns on horizontal flare units of production wells that is associated with technical routine processes and well stock operation schemes

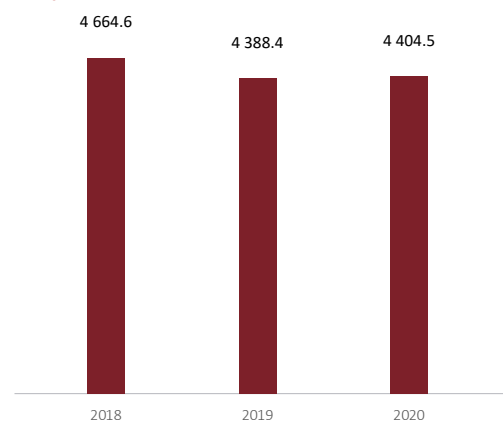
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The structure of water abstraction by Naftogaz Group companies by sources in 2020, %



7

Volumes of water used by Naftogaz Group companies in 2018-2020, tcm



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 2009.⁶ Most gas-cleaning plants are used to purify the gas and dust stream from dust particles (dry mechanical dust collectors, dry inertial and rotary 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 form⁷ 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.

Contribution to coping with climate change

In 2020, Naftogaz Group entities generated cumulatively 2,217.3 kt of CO₂-equivalent of greenhouse gas emissions, which is 70% lower than the previous year. The main reasons for this reduction of greenhouse gas emissions was the division of the gas transmission system, or unbundling. The main input into total volume of greenhouse gas emissions was made by Ukrigasvydobuvannya and Ukrnafta, with 58.6% and 26.8% respectively. ⁵

Elimination of gas pollution in Boryslav

In 2020, Ukrnafta continued development and implementation of measures aimed at elimination of the aftermath of long-lasting oil and gas production, as well as reduction of gas environmental pollution in Boryslav. As of 1 January 2021, Ukrnafta's cumulative costs for implementing these measures amounted to UAH 37.5 m among. UAH 1.7 m was for preventive measures; UAH 14.6 m for repair and insulation works; and UAH 21.2 m for operation and reconstruction of facilities related to elimination of gas pollution in the town.

On top of this, in 2020, a company specialised in oil spill response and environmental clean-up operations, Lamor Ukraine, commenced work on comprehensive monitoring in Boryslav. These services cost UAH 5.6 m.

WATER RESOURCE MANAGEMENT

Water use

In total, in 2020, Naftogaz Group companies withdrew 4,536.9 tcm of water, more than half (63.4%) of that amount came from surface water. The production activity of Naftogaz companies does not impact water withdrawal sources. ⁶

The volume of water actually used by the companies in 2020 amounted to 4,404.5 tcm. In terms of Naftogaz Group companies, Ukrnafta and Ukrigasvydobuvannya used the largest amount of water, at 57.6% and 25.9% of the total volume respectively. More than half of the total volume of water (68.2% or 3,002.8 tcm) was used for production and technological needs. The

volume of reused and multi-used water in 2020 amounted to 147.8 mmcm. ^{7 8 9}

Naftogaz Group companies have also collected associated reservoir water, which is produced together with hydrocarbons, with a total volume of 8,631.1 tcm as a result of well operations. In order to reduce adverse impact on soils, as well as on surface water and groundwater, associated reservoir water was returned to underground layers through absorbing wells.

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.

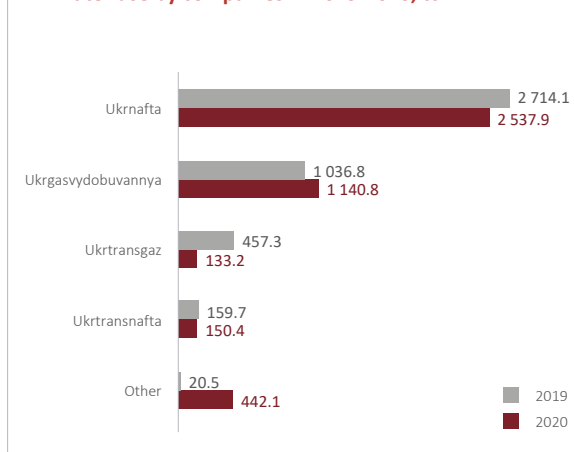
Wastewater management

The total volume of wastewater discharged by Naftogaz Group companies in 2020 amounted to 992.1 tcm, which is 23.4% less than in the previous year. ¹⁰

Wastewater quality control is carried out in line with the Order of the Ministry of Communities and Territories Development No.316⁸ of 1 December 2017, the Law of Ukraine "On Drinking Water, Drinking Water Supply and Water Disposal" and the resolution of the Cabinet of Ministers of Ukraine of No.465⁹ of 25 March 1999. Discharge of wastewater into water bodies is permitted only in compliance with the standards of maximum allowable concentrations (MACs) and standards of maximum allowable discharge (MAD) of the pollutants, which is set pursuant to a special water use permit. The procedure for wastewater collection into public water disposal systems in residential areas is established by the relevant local regulations. Pursuant to the rules on acceptance of wastewater from subscribers into the sewer system of Kyiv,¹⁰ the company controls concentrations of pollutants in wastewater, namely: suspended particulate matter, dry residue, phosphates, ammonium (ammonium nitrogen), chlorides, sulphates, petroleum products, synthetic surfactants and fats.

8

Water use by companies in 2019-2020, tcm



WASTE MANAGEMENT

Naftogaz Group's approaches to waste management are established in line with the provisions of the Law of Ukraine "On Waste".

In 2020, Naftogaz companies generated a total of 132.9 thousand tons of waste, most of which (89.0%) belong to low-hazardous waste class (hazard class IV)¹¹. Second came moderately hazardous waste (class III), which amounted to 13.4 thousand tons or 10.1% 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 companies, Ukrigasvydobuvannya and Ukrnafta have generated the largest volume of waste at 68.2% and 30.0% of the total amount respectively.

Naftogaz Group has developed and put in force technical specifications "Dried drilling cuttings. TY Y 08.9-30019775-001: 2020" aiming to optimise the flow chart of drilling waste management. These technical specifications established requirements for the quality of drilling cuttings, which can be used as building material for roads, diking of flare pits of wells, land site restoration after drilling, backfilling, and layering of landfills for solid domestic waste and industrial waste. ¹¹

The existence of a valid license for recycling activities is the main criterion of Naftogaz Group when selecting organisations for recycling and waste disposal services.

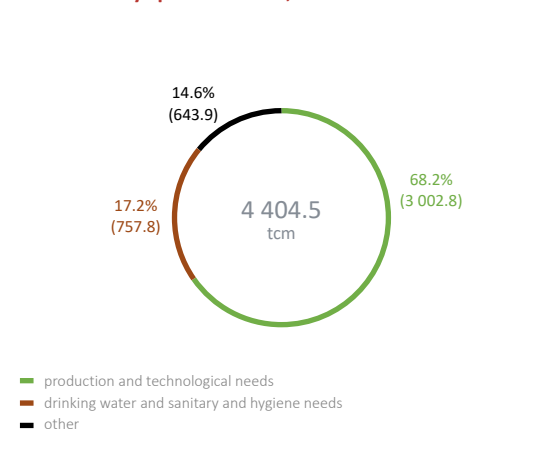
In December 2020, an online training seminar "Household solid waste management. Let's sort it out" was held. More than 50 employees from the HQ of National Joint Stock Company Naftogaz of Ukraine and representatives of Naftogaz Group companies participated.

SOIL RESTORATION

Naftogaz Group implements approaches to the environmental rehabilitation of soils within the framework of the Key Civil Defence Action Plan of National Joint Stock Company "Naftogaz of Ukraine" and Naftogaz Group companies for 2020. This Action Plan provides for the introduction of state-of-art technologies for restoration and treatment of man-made disturbed ecosystems.

9

Water use by sphere in 2020, tcm



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"

⁷ Form of state statistical observation № 2-TP (air)

⁸ Mandate of the Ministry of Communities and Territories Development of 01.12.2017 No 316 "On approval of the Rules of acceptance of wastewater into centralized drainage systems and the Procedure for determining the amount of the fee charged for excessive discharges of wastewater into centralized drainage systems"

⁹ CMU Resolution No. 485 of 25.03.1999 No 465 "On approval of the Rules for the protection of surface waters from pollution by return waters"

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"

¹¹ Classification according to DsanPiN 2.2.7.029-99, repealed in accordance with the decision of the State Service of Ukraine for Regulatory Policy and Entrepreneurship Development dated 15.07.2014 No 33. As of the end of 2020, no new regulatory document is available as a basis for determination of the waste hazard class.

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
tcm of treated wastewater under the regulations at the treatment facilities by means of biological treatment

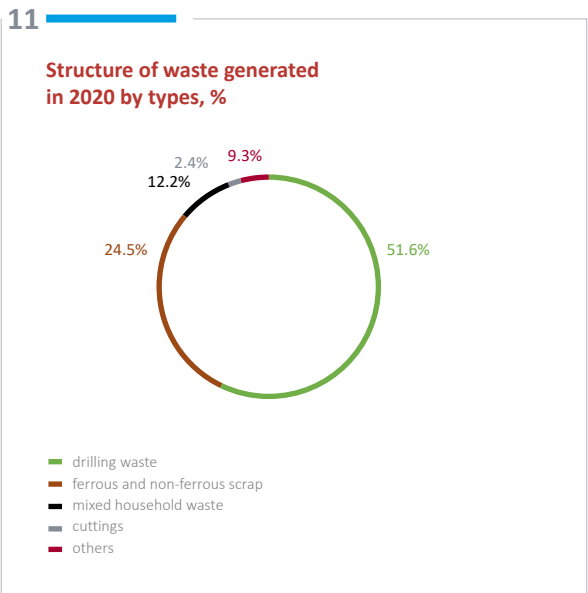
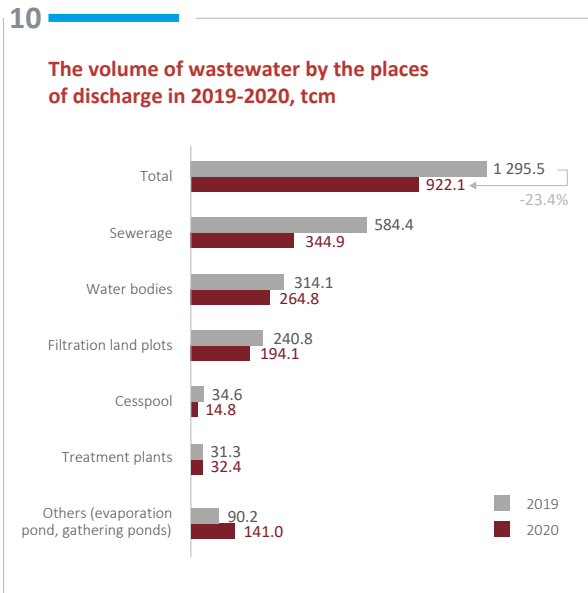
182.7 tcm
with the help of mechanical treatment

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 by hazard classes and methods of disposal in 2019-2020

Method of disposal	2019		2020	
	Hazardous waste (I-III class), kt	Low hazardous waste (class IV), kt	Hazardous waste (I-III class), kt	Low hazardous waste (class IV), kt
Disposed	3.9	0.1	1.7	0.1
Incinerated	0.0	0.04	0.0	0.02
Removed	0.008	101.7	0.3	72.2
Passed to other organisations	12.1	78.0	11.3	45.7
Exported	0.0008	0.1	0.0	0.1
Total	15.0	244.6	14.7	118.2

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 74.2-20077720-34: 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 Mashivskiyi 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 developed¹² the “Emerald Network Facility Management Plan: Wetland Eastern Sivash” (“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 intersection 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 upfront detection of environmental risks associated with Naftogaz Group production activities.



PLANS FOR 2021

- Implementation of Project Agreement with the EBRD on the reduction of methane emissions at Naftogaz Group company facilities.
- Organisation of reporting in the Oil and Gas Methane Partnership (OGMP) system.
- Development of a monitoring plan in accordance with the requirements of the monitoring, reporting and verification (MRV) system and submission for approval to the Ministry of Ecology and Mineral Resources. Monitoring of greenhouse gas emissions during the first reporting period (2021). Selection of a verifier and entry into a service contract.
- Resolving the matter on extending work on the development of technological standards for existing and new gas turbines and engines whose rated thermal power ranges from 1 to 50 MWh.
- Further implementation of an environmental management system in line with the requirements of international standards ISO 14001.
- Conduct of environmental audits of Naftogaz Group companies.

¹² Conclusion on the environmental impact assessment of the planned activity «Continuation of industrial production of hydrocarbons at the Strelkove gas field» of 02.07.2019 №7-03/12-2019493369/

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.

The company’s energy management systems are implemented and improved by the Energy Efficiency Department of Naftogaz Group. In 2020, the department elaborated an action plan to meet the requirements of ISO 50001:2018. Based on the results of an external supervisory assessment, the Naftogaz Group integrated management system was certified for compliance with ISO 50001:2018 in September 2020.

Energy use

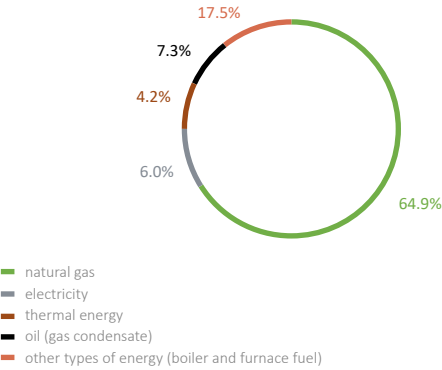
In the reporting period, Naftogaz Group enterprises consumed a total of 1.2 million toe of fuel and energy to satisfy the technological needs of extraction, preparation, and storage of natural gas and oil, including:

- 0.9 bcm of natural gas;
- 0.9 billion kWh of electricity;
- 410.4 thousand Gcal of thermal energy;
- 84.4 thousand tons of oil (gas condensate);
- 201.7 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.

1

Production and technological energy use in 2020, %

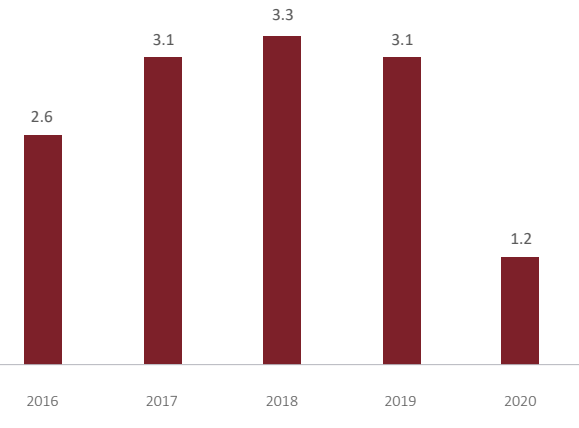


Production and technological fuel and energy costs in 2020

Naftogaz Group companies	Total energy thousand oil equivalent	including			
		natural gas mcm	electricity million kWh	thermal energy thousand Gcal	other types of energy thousand toe
Ukrtransgaz	79.2	92.6	16.7	23.0	0
Ukrigasvydobuvannya	517.1	584.0	253.5	182.1	1.7
Ukrnafta	541.8	241.8	481.2	193.8	406.3
Ukrtransnafta	10.6	0.4	115.3	7.9	0.3
Ukravtogaz	2.9	1.9	13.4	2.7	0
Ukrspetstransgaz	0.3	0.0	0.1	0.1	0.4
Chornomornaftogaz	0.2	0.3	0.0	0	0
Total	1,152.1	920.9	880.3	409.6	408.7

2

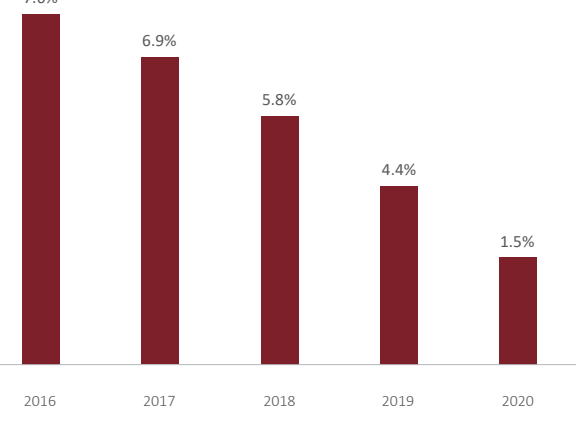
Use of fuel and energy in 2016-2020, million toe



¹ Fuel and energy savings (relative to the total consumption) are calculated as the ratio of the volume of fuel and energy saved as a result of the implementation of energy saving measures by the company in the reporting period to the total fuel and energy consumption, should no such measures be implemented

3

Share of fuel and energy savings in the total fuel and energy consumption in 2016-2020, %¹



The “per unit” energy intensity indicators for the activities of the company in the reporting period were as follows:

- Oil transportation – 0.0011 toe / thousand ton * km
- Oil production (Okhtyrkanaftogaz NGVU) – 0.0483 toe /t
- Gas processing (Dolyna refinery, Kachaniv refinery) – 63.48 toe / mcm

Results of energy saving measures

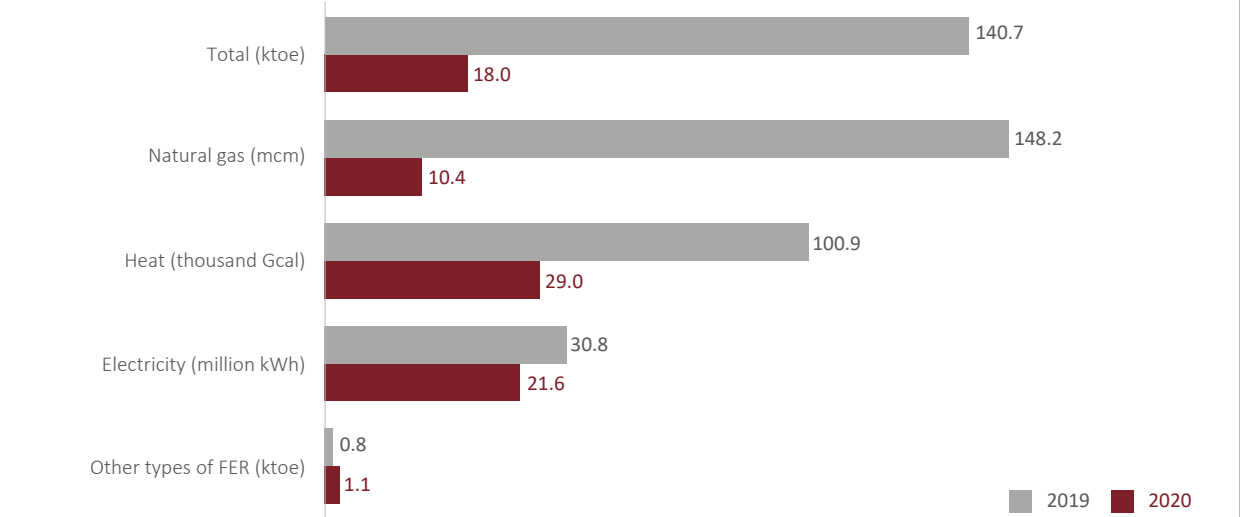
During 2020, the implementation of energy saving and energy efficiency initiatives by Naftogaz Group resulted in a reduction of its energy consumption by 18.0 thousand toe. The following fuel and energy economies contributed to the total result:

- 10.4 mcm of natural gas;
- 29.0 thousand Gcal of thermal energy;
- 21.6 million kWh of electricity;
- 1.1 thousand toe of other fuel.

The total cost of saved fuel and energy in 2020 amounted to UAH 147.7 million (including VAT).

4

Naftogaz Group fuel and energy savings in 2019-2020

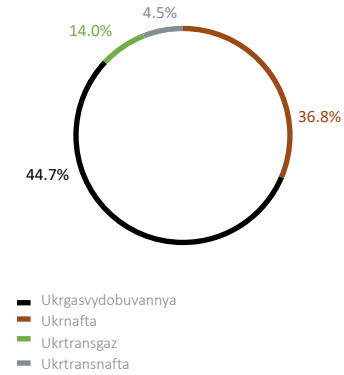


In terms of the company's enterprises, the largest contribution to the reduction of overall energy consumption in production processes was made by Ukrnafta and Ukrigasvydobuvannya – 6.6 thousand toe and 8.0 thousand toe, respectively. They are followed by Ukrtransgaz (2.5 thousand toe) and Ukrtransnafta (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.

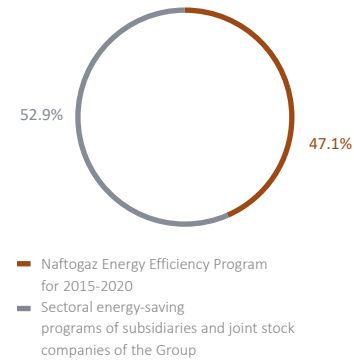
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Decrease in energy consumption by Naftogaz Group enterprises in 2020, %



6

Reduction of fuel and energy consumption under the energy saving programs in 2020, %



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:

Electricity

85 million kWh

Thermal energy

516 thousand Gcal

Natural gas

763 mcm

Total

704 thousand toe

Energy efficiency projects

In order to achieve the goals of the Naftogaz of Ukraine NJSC Energy Efficiency Program for 2015-2020, 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

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Address of Naftogaz Group CFO

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 3.2 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 look to the future with confidence. We are transforming Naftogaz with a focus on building a new performance-oriented culture, promotion of personal accountability, and efficiency across the group. Naftogaz will then be able to ensure energy independence for the country, generate more value for the people of Ukraine, and get ready for an IPO in the medium term.



"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

Key financial indicators

Naftogaz Group reports consolidated net loss of UAH 19.0 billion for the year ended 31 December 2020 compared with a profit of UAH 2.6 billion for 2019, reflecting lower demand and gas prices, and material provisions for bad debts.

Profit for 2020

UAH 3.2 bn*

The underlying profit for 2020, excluding provisions for bad debts and other unusual items

*excluding the PSO compensation, provision for doubtful debts, relevant taxes, and effect of the transaction with Ukrnafta

Total contribution paid to the State Budget

UAH 141.0 bn

A dividend of UAH 39.6 billion was paid in 2020 and a dividend of UAH 8.5 billion was prepaid late 2019

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 at the end of 2020.
- 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.

PERFORMANCE BY SEGMENT

Exploration and production result reflected lower gas prices that were partially offset by lower subsoil royalties as compared to 2019.

Oil midstream and downstream was primarily attributable to lower selling prices for petroleum products which were not wholly offset by attributable cost savings over the period.

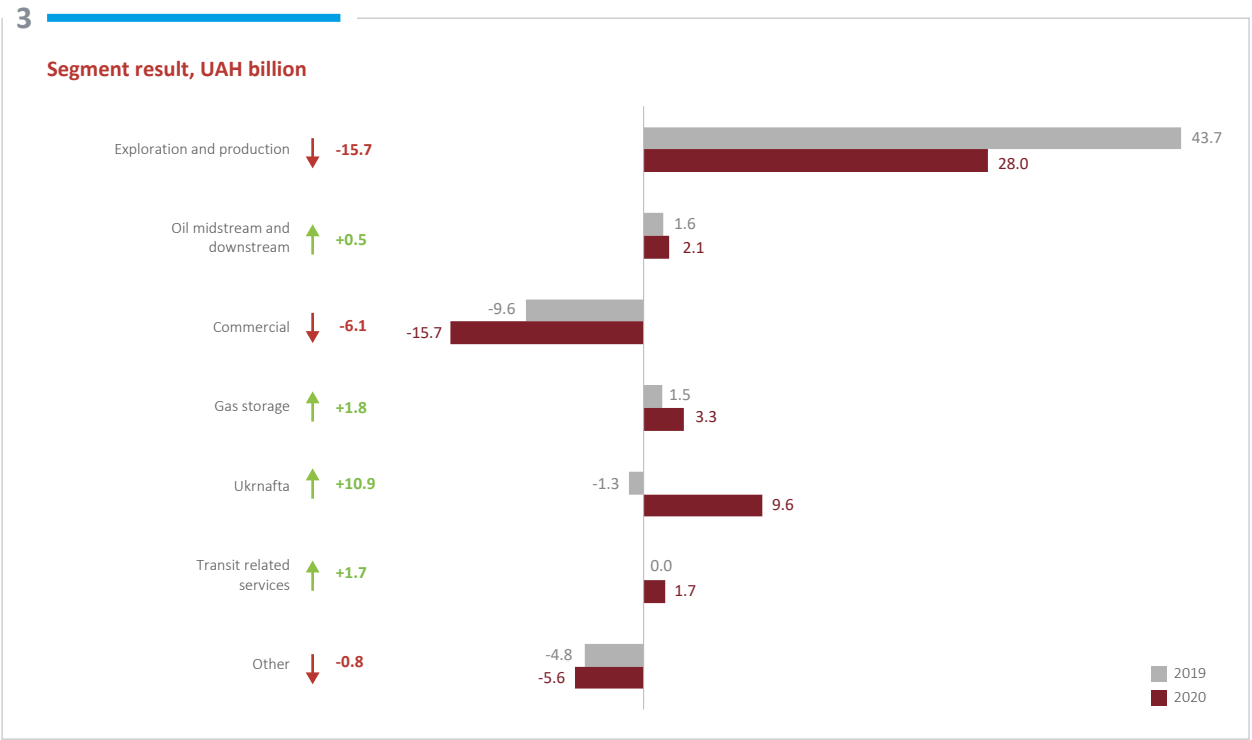
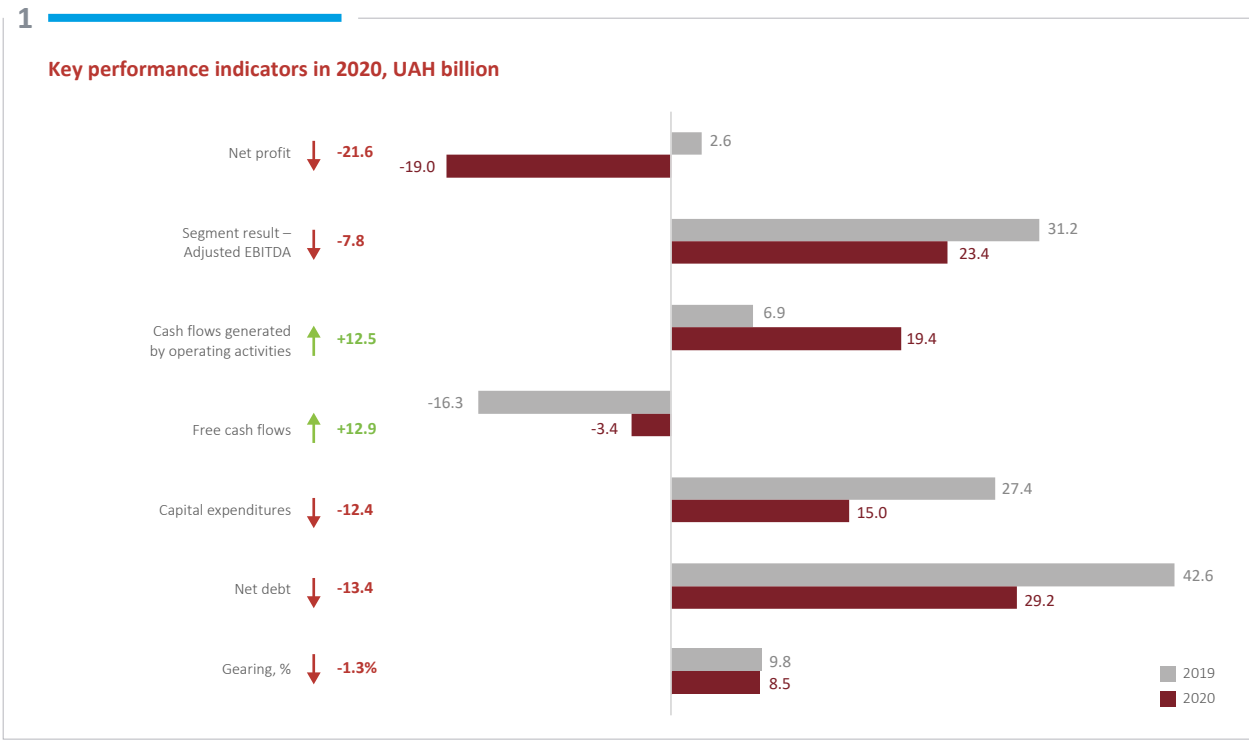
The performance of the Commercial (incl. PSO compensation) was negatively impacted by lower volumes and sales prices offset by lower purchases, as well bad debt provisions.

Gas storage reflected higher revenues from pumping and storage services due an increased demand.

Compensation (after tax)

UAH 26.4 bn

government provided compensation for gas deliveries under the PSO during 2015 to 2019



Taxes

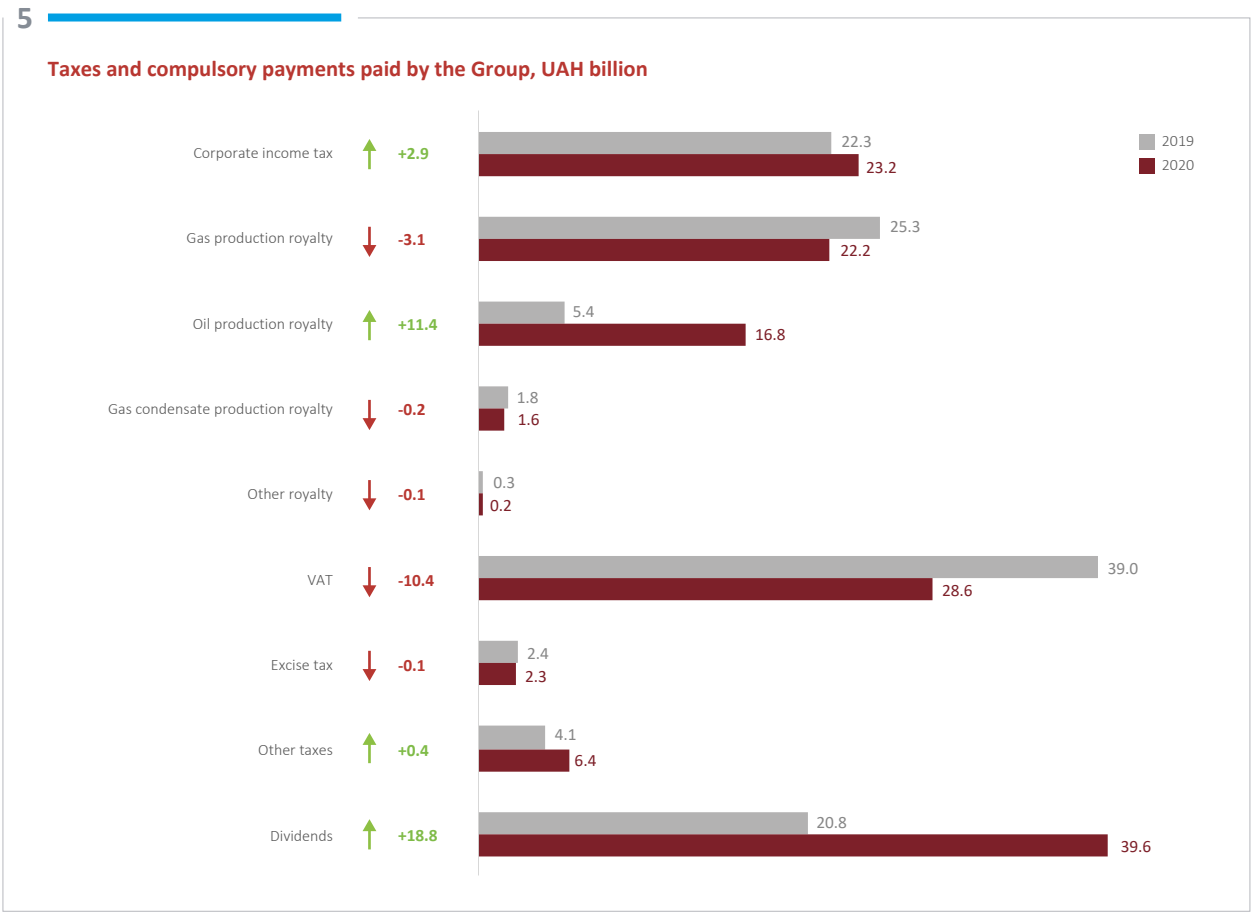
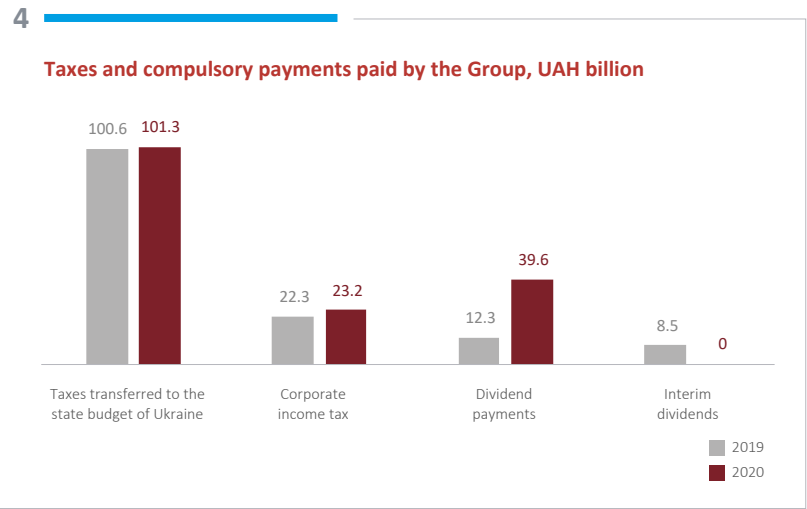
UAH **23.2** billion
income tax paid by the Group

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.

Cash flow

UAH **19.5** bn
despite harsh conditions, operating cash flow in 2020 more than doubled compared to 2019

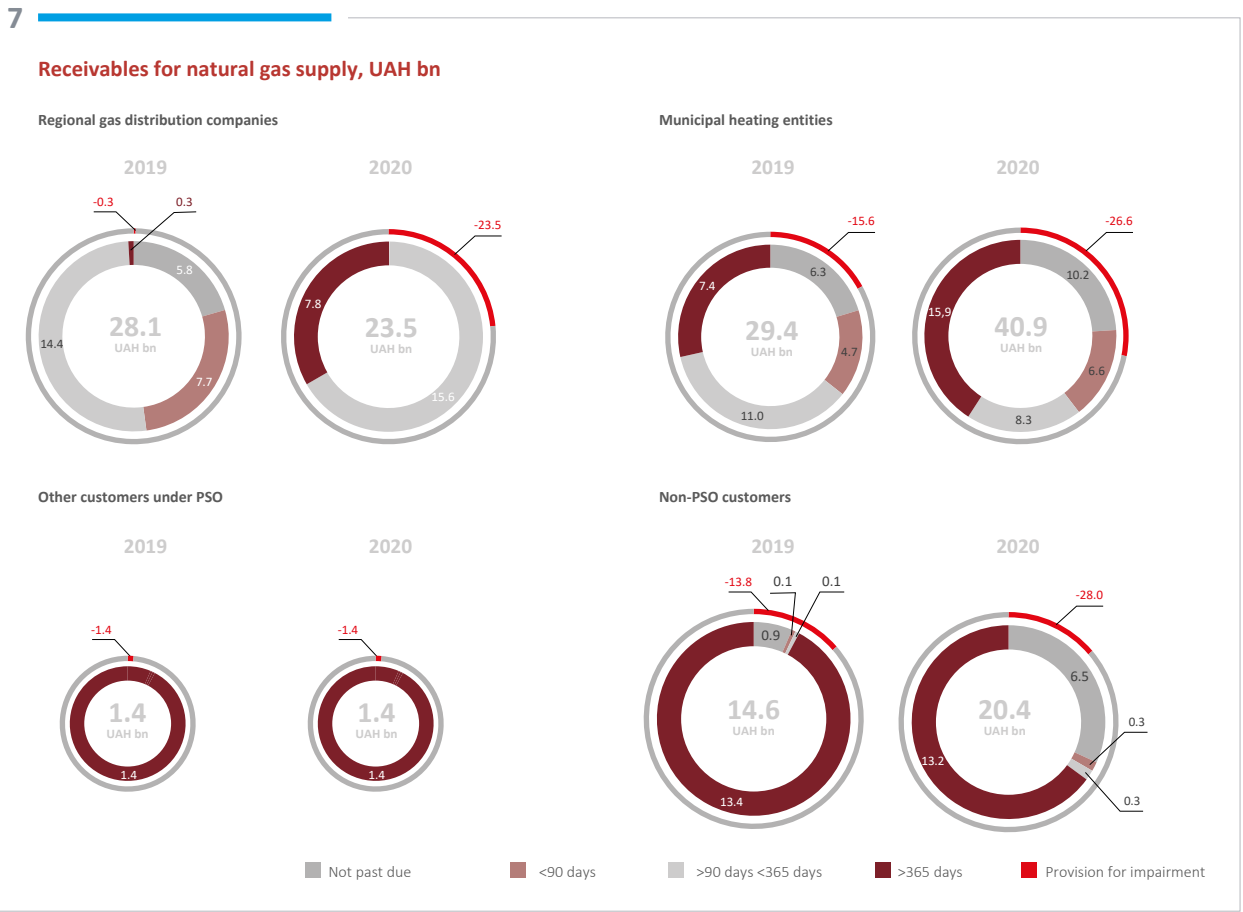
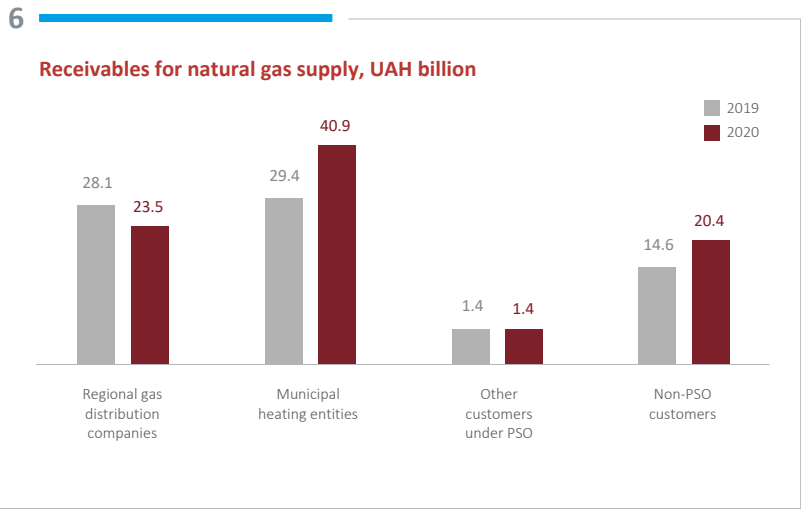


CONTRIBUTIONS TO THE STATE BUDGET

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.



Gross gas production in 2020

15.4 bcm

Gas sales in 2020

18.2 bcm

Capital expenditure in 2020

46 %
lower 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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INDEPENDENT AUDITOR’S REPORT

To the Shareholder of Joint Stock Company “National Joint Stock Company “Naftogaz of Ukraine”:

Report on the Audit of the Consolidated Financial Statements

OPINION

We have audited the consolidated financial statements of Joint Stock Company “National Joint Stock Company “Naftogaz of Ukraine” and its subsidiaries (the “Group”), which comprise the consolidated statement of financial position as at 31 December 2020, the consolidated statement of profit or loss, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2020, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (“IFRSs”) and the preparation of the consolidated financial statements requirements of the Law of Ukraine “On accounting and financial reporting in Ukraine” (“Law on accounting and financial reporting”).

BASIS FOR OPINION

We conducted our audit in accordance with International Standards on Auditing (“ISAs”). Our responsibilities under those standards are further described in the Auditor’s Responsibilities

for the Audit of the Consolidated Financial Statements section of our report. We are independent of the Group in accordance with the International Ethics Standards Board for Accountants’ Code of Ethics for Professional Accountants (the “IESBA Code”) together with the ethical requirements that are relevant to our audit of the consolidated financial statements in Ukraine, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

EMPHASIS OF MATTER

Operating environment

We draw your attention to Note 2 to the consolidated financial statements, which describes that the impact of the ongoing political and economic situation in Ukraine is unpredictable and may have significant effect on the Ukrainian economy and the operations of the Group. Our opinion is not modified in respect of this matter.

KEY AUDIT MATTERS

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Why the matter was determined to be a key audit matter	How the matter was addressed in the audit
<p>unobservable inputs and assumptions. In addition, fair value model is highly sensitive to the assumptions used to determine economic impairment, such as the annual volumes of oil transit, volume of hydrocarbons extraction, future gas sales price, future Euro and USD exchange rates and the discount rate.</p> <p>For more details, please refer to Note 5 “Property, Plant, and Equipment”, as well as Note 23 “Fair Values” and Note 26 “Critical Accounting Estimates and Judgments”.</p>	<p>correctness of the amounts recorded and presented in the consolidated financial statements;</p> <p>— assessing completeness and accuracy of the information disclosed in the consolidated financial statements.</p>
<p>EXPECTED CREDIT LOSSES ON TRADE ACCOUNTS RECEIVABLE</p> <p>Estimate of allowance for expected credit losses on trade accounts receivable involves application of complex methodology, use of management’s judgement and various subjective assumptions.</p> <p>Taking into account the significance of the trade accounts receivable balance, complexity of calculations and high level of subjectivity of judgements and assumptions we considered measurement of expected credit losses on trade accounts receivable to be a key audit matter.</p> <p>Refer to the Note 9 “Trade accounts receivable” as well as Note 25 “Summary of significant accounting policies” of the accompanying consolidated financial statements for further details.</p>	<p>We obtained understanding of the Group’s policy, processes and control procedures for measurement of expected credit losses on trade accounts receivable.</p> <p>We assessed the Group’s methodology on the expected credit losses calculation on a collective basis in accordance with the requirements of IFRS 9 “Financial Instruments”.</p> <p>We tested the Group’s historical data on credit losses incurred based on a sample of trade accounts receivable and performed alternative recalculation of the expected credit losses that are determined on a collective basis.</p> <p>We also assessed the appropriateness of management’s judgment regarding assessment of expected loss rates and the historical period for which statistics can be used for calculating expected credit losses that are assessed on a collective basis.</p> <p>We further assessed trade accounts receivable for the default criteria, that included critical assessment of the information used by the Group to assess the ability of its customers to repay their debts.</p> <p>We checked completeness and accuracy of the relevant disclosures in the consolidated financial statements.</p>

Why the matter was determined to be a key audit matter	How the matter was addressed in the audit
<p>DETERMINING THE FAIR VALUES OF PROPERTY, PLANT, AND EQUIPMENT</p> <p>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).</p> <p>Determining the fair values of property, plant and equipment is a key audit matter since it requires applying subjective</p>	<p>We obtained understanding of and evaluated the Group’s policies, processes, methods, and assumptions used to assess the fair values of property, plant, and equipment.</p> <p>With the involvement of our valuation experts we performed the following procedures:</p> <ul style="list-style-type: none">— evaluating whether the methodology applied and the model used are in line with the international valuation standards and IFRS 13 “Fair value”;— based on our experience with the Group, our knowledge of its business activities and the industry in which the Group operates, challenging management’s judgments and analyzing validity of the key assumptions used in determining the fair values;— assessing the accuracy of inputs used in the valuation model by tracing them on a sample basis to supporting documents;— checking the mathematical accuracy of the model and

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 2020 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 81,306 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

We obtained understanding of and evaluated the Group’s policies, processes and methods related to the disposal of the subsidiary, the initial recognition and measurement of consideration receivable for their appropriateness, and assumptions used to assess the fair values of consideration receivable.

With the involvement of our valuation experts we performed the following procedures:

- evaluating whether the methodology applied and the model used are correct, reasonable and in line with our understanding;
- based on our experience with the Group, our knowledge of its business activities and the industry in which the Group operates, challenging management’s judgments and analyzing validity of the key assumptions used in determining the fair value;
- checking the mathematical accuracy of the model and correctness of the amounts recorded and presented in the consolidated financial statements;
- assessing completeness and accuracy of the information disclosed in the consolidated financial statements.

Why the matter was determined to be a key audit matter

How the matter was addressed in the audit

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.

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 financials 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 appears 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.

Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements

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.

Auditor’s Responsibilities 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 ISAs 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 ISAs, 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

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 direction, 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 communicated 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.

Report on Other Legal Requirements

We have been appointed as auditor of the Group by the Supervisory Board on 17 September 2019. In view of the previous renewals and reappointments, we conducted audit from 12 September 2014 to the date of this report.

We confirm that the audit opinion is consistent with the additional report to the audit committee.

We confirm that the prohibited non-audited services referred to ISA or requirements of Article 6, paragraph 4 of Law of Ukraine «On Audit of Consolidated financial statements and Audit Activities» were not provided and that the audit engagement partner and audit firm remains independent of the Group in conducting the audit.

Basic Information about Audit Firm

Name: LIMITED LIABILITY COMPANY “DELOITTE & TOUCHE UKRAINIAN SERVICES COMPANY”

Address of registration and location of audit firm: 48, 50a Zhylianska Str., Kyiv, 01033, Ukraine.

“Limited Liability Company “Deloitte & Touche Ukrainian Services Company” was enrolled to Sections of “Audit Entities”, “Audit Entities and Auditors That Have the Right to Conduct Statutory Audits of Financial Statements”, and “Audit Entities and Auditors That Have the Right to Conduct Statutory Audits of Financial Statements of Public Interest Entities” of the Register of Auditors and Auditing Entities of the Audit Chamber of Ukraine under #1973.”

Certified Auditor

Mykhailo Melnyk

Auditor’s Certificate # 007501
Issued by the Audit Chamber of Ukraine on 21 December 2017 on the basis of Resolution of the Audit Chamber of Ukraine # 353/2
Registration Number in the Register of Auditors and Auditing Entities 102406

LLC “Deloitte & Touche Ukrainian Services Company”
48, 50a Zhylianska Str., Kyiv, 01033, Ukraine

25 March 2021

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2020

<i>In millions of Ukrainian hryvnias</i>	Note	31 December 2020	31 December 2019
ASSETS			
Non-current assets	5	211,134	240,506
Property, plant and equipment	6	772	835
Investments in associates and joint ventures	19	7,685	10,439
Deferred tax assets	20	63,432	-
Consideration receivable under the SPA	7	6,039	8,505
Other non-current assets	2	9,375	-
Prepaid corporate income tax			
Total non-current assets		298,437	260,285
Current assets	8	40,691	57,705
Inventories	9	28,129	59,056
Trade accounts receivable	10	22,641	9,887
Prepayments made and other current assets	20	17,626	-
Consideration receivable under the SPA		702	263
Prepaid corporate income tax		37,106	77,593
Cash and bank balances		659	436
Restricted cash			
Assets of discontinued operations classified as held for sale and distribution	20	-	115,355
Total current assets		147,554	320,295
TOTAL ASSETS		445,991	580,580
EQUITY			
	11	194,307	194,307
Share capital		140,171	316,264
Revaluation reserve		4,069	3,340
Foreign currency translation reserve		(27,801)	(123,234)
Accumulated deficit			
Equity attributable to owners of the Parent		310,746	390,677
Non-controlling interest in equity		3,535	1,897
TOTAL EQUITY		314,281	392,574
LIABILITIES			
Non-current liabilities			
Borrowings	12	56,547	47,148
Provisions	13	9,853	10,588
Deferred tax liabilities	19	12,910	18,858
Other long-term liabilities		3,354	2,691
Total non-current liabilities		82,664	79,285
Current liabilities			
Borrowings	12	9,795	13,514
Provisions	13	13,576	42,841
Trade accounts payable		3,585	5,061
Advances received and other current liabilities	14	20,277	19,494
Corporate income tax payable		1,813	10,471
Liabilities of discontinued operations classified as held for sale and distribution	20	-	17,340
Total current liabilities		49,046	108,721
TOTAL LIABILITIES		131,710	188,006
TOTAL LIABILITIES AND EQUITY		445,991	580,580

These consolidated financial statements were authorised for issue on 23 March 2021.

Andriy Kobolyev
Chairman of the Executive Board

Petrus Stephanus Van Driel
Chief Financial Officer

CONSOLIDATED STATEMENT OF PROFIT OR LOSS FOR THE YEAR ENDED 31 DECEMBER 2020

<i>In millions of Ukrainian hryvnias</i>	Note	2020	2019
Revenue	3	159,234	149,781
Compensation for performing public service obligations	2	32,205	-
Interest and other income		1,578	2,052
Total revenue and other income		193,017	151,833
Production and manufacturing expenses	15	(48,222)	(53,870)
Purchases	16	(64,558)	(41,589)
Depreciation, depletion and amortisation		(16,548)	(14,208)
Research, development and exploration costs		(588)	(804)
Impairment loss	5	(7,950)	(9,424)
Selling, general and administrative expenses	17	(21,340)	(16,015)
Finance costs	18	(6,738)	(6,377)
Net movement in provision for financial assets	7, 9, 10	(42,595)	(6,471)
Total expenditure		(208,539)	(148,758)
Foreign exchange gain		1,545	1,937
Share of after-tax results of associates and joint-ventures	6	(65)	(121)
(Loss)/profit before income tax		(14,042)	4,891
Income tax expense	19	(4,960)	(2,310)
Net (loss)/profit for the period from continuing operations		(19,002)	2,581
Discontinued operations:			
Profit for the period from discontinued operations	20	-	60,713
Net (loss)/profit		(19,002)	63,294
Net (loss)/profit is attributable to:			
Owner of the Company from:			
Continuing operations		(20,851)	4,330
Discontinued operations		-	60,713
Non-controlling interest from:			
Continuing operations		1,849	(1,749)
Discontinued operations		-	-
Net (loss)/profit		(19,002)	63,294
Other comprehensive (loss)/income			
Items that will not be reclassified subsequently to profit or loss, net of income tax:			
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)		(15,889)	(57,929)
Share of other comprehensive income of associates, net of income tax effect of nil (2019: nil)		-	133
Remeasurement of defined benefit obligation, net of income tax effect of UAH 125 million (2019: UAH 113 million)		592	(1,020)
Remeasurement of decommissioning liability (net of income tax effect of UAH 82 million (2019: UAH 375 million)		371	(1,710)
Items that may be reclassified subsequently to profit or loss, net of income tax:			
Foreign currency translation reserve		729	(687)
Other comprehensive loss		(14,197)	(61,213)
Total comprehensive (loss)/income		(33,199)	2,081
Total comprehensive (loss)/income is attributable to:			
Owner of the Company from:			
Continuing operations		(34,279)	(58,685)
Discontinued operations		-	60,713
Non-controlling interest from:			
Continuing operations		1,080	53
Discontinued operations		-	-
Total comprehensive (loss)/income		(33,199)	2,081

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2020

Equity attributable to owners of the Parent						
	Share capital	Revaluation reserve	Foreign currency translation reserve	Accumulated deficit	Total	Non-controlling interest
						Total equity
In millions of Ukrainian hryvnias						
Balance at 31 December 2018	194,307	379,022	4,027	(165,342)	412,014	1,844
Profit/(loss) for the year	-	-	-	65,043	65,043	(1,749)
Other comprehensive (loss)/income for the year	-	(61,540)	(687)	(788)	(63,015)	1,802
Total comprehensive (loss)/income for the year	-	(61,540)	(687)	64,255	2,028	53
Transfer of revaluation reserve	-	(1,218)	-	1,218	-	-
Provision for dividends payable to the State Budget (Notes 11)	-	-	-	(15,197)	(15,197)	-
Profit share paid to the State Budget (Note 11)	-	-	-	(8,168)	(8,168)	-
Balance at 31 December 2019	194,307	316,264	3,340	(123,234)	390,677	1,897
(Loss)/Profit for the year	-	-	-	(20,851)	(20,851)	1,849
Other comprehensive (loss)/income for the year	-	(14,686)	729	529	(13,428)	(769)
Total comprehensive (loss)/income for the year	-	(14,686)	729	(20,322)	(34,279)	1,080
Transfer of revaluation reserve (Note 20)	-	(161,407)	-	161,407	-	-
Change in investments in joint operations	-	-	-	6	6	6
Part of non-controlling interest of transaction between Group companies	-	-	-	(2,473)	(2,473)	2,473
Provision for dividends payable to the State Budget and to other equity holders (Note 11)	-	-	-	(1,921)	(1,921)	(1,921)
Profit share paid to the State Budget (Note 11)	-	-	-	(32,928)	(32,928)	-
Loss on disposal of subsidiary (Note 20)	-	-	-	(8,336)	(8,336)	-
Balance at 31 December 2020	194,307	140,171	4,069	(27,801)	310,746	3,535

CONSOLIDATED STATEMENT OF CASH FLOWS, FOR THE YEAR ENDED 31 DECEMBER 2020

	Note	2020	2019
In millions of Ukrainian hryvnias			
CASH FLOWS FROM OPERATING ACTIVITIES			
Loss)/profit before income tax from continuing operations		(14,042)	4,891
Profit before income tax from discontinued operations	20	-	77,360
Adjustments for:			
Depreciation of property, plant and equipment and amortisation of intangible assets		16,548	34,439
Loss on disposal of property, plant and equipment and intangible assets		505	847
Impairment of property, plant and equipment and intangible assets	5	7,950	10,230
Write down of inventories	8	96	2,457
Net movement in provision for trade accounts receivable, prepayments made and other assets		42,697	21,683
Fair value remeasurement of financial assets		321	-
Change in provisions	13	3,232	3,331
Write off of accounts payable and other current liabilities		(41)	(192)
Share of after-tax results of associates and joint-ventures		65	121
Net foreign exchange loss	6	(1,545)	(1,414)
Finance costs, net		5,160	4,758
Operating cash flows before working capital and other changes		60,946	158,511
Decrease in other non-current assets		88	758
Decrease/(increase) in inventories		17,415	(1,341)
Increase in trade accounts receivable		(7,105)	(16,305)
Decrease/(increase) in prepayments made and other current assets		3,003	(4,488)
Decrease in other long-term liabilities		(2)	(265)
Provisions paid or used		(32,982)	(3,667)
Decrease in trade accounts payable	13	(1,473)	(155)
Increase/(decrease) in advances received and other current liabilities		2,805	(2,160)
Cash generated from operations		42,695	130,888

(CONTINUED)

	Note	2020	2019
In millions of Ukrainian hryvnias			
Income taxes paid		(23,245)	(22,296)
Net cash generated by operating activities		19,450	108,592
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of property, plant and equipment and intangible assets		(15,044)	(27,683)
Proceeds from sale of property, plant and equipment		9	137
Withdrawal of bank deposits		-	1,466
(Placement)/withdrawal of restricted cash		(223)	903
(Acquisition)/proceeds from sale of the State treasury bonds	10	(12,269)	148
Proceeds from sale of subsidiary	20	3,851	-
Dividends received		-	19
Interest received		846	1,443
Net cash used in investing activities		(22,830)	(23,567)
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from borrowings	12	6,136	43,865
Repayment of borrowings	12	(10,826)	(34,844)
Interest paid	12	(6,190)	(5,419)
Profit share and dividends paid	11, 13	(39,625)	(20,754)
Net cash used in financing activities		(50,505)	(17,152)
Net (decrease)/increase in cash and cash equivalents		(53,885)	67,873
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR		77,593	12,759
Effect of exchange rates change on cash and cash equivalents		13,398	(3,039)
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR		37,106	77,593

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020

1. THE ORGANISATION AND ITS OPERATIONS

Joint Stock Company “National Joint Stock Company “Naftogaz of Ukraine” (“Naftogaz”, the “Parent” or 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 the Executive Board 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 stakes in various entities that form the national system of production, refinery, distribution, transportation, and storage of natural gas, gas condensate and oil.

The Company is registered at 6 B. Khmelnytskoho Street, Kyiv, Ukraine.

These consolidated financial statements were authorised for issue by the Executive Board on 23 March 2021.

The sale of “Gas Transmission System Operator of Ukraine” LLC was completed on 1 January 2020 (Note 20). The Group conducts its business and holds its production facilities mainly in Ukraine. The principal subsidiaries and joint operations are:

Name/Type of activity	% Interest held as at 31 December		Subsidiary/ Joint operations	Country of registration
	2020	2019		
Production of gas, oil and refinery products				
Ukr gasvydobuvannya, JSC	100.00	100.00	Subsidiary	Ukraine
Ukrnafta, PJSC	50.00 + 1 share	50.00 + 1 share	Subsidiary	Ukraine
Petrosannan Company, Joint operations with the Arab Republic of Egypt and Egyptian General Petroleum Corporation (“EGPC”)	50.00	50.00	Joint operations	Egypt
Zakordonnaftogaz, SE	100.00	100.00	Subsidiary	Ukraine
Oil and gas transportation and storage				
Ukrtransgaz, JSC	100.00	100.00	Subsidiary	Ukraine
Gas Transmission System Operator of Ukraine, LLC	0.00	100.00	Subsidiary	Ukraine
Ukrtransnafta, JSC	100.00	100.00	Subsidiary	Ukraine
Ukrspectransgaz, JSC	100.00	100.00	Subsidiary	Ukraine
Wholesale and retail distribution of oil, gas and refinery products				
Gaz Ukraini, SE	100.00	100.00	Subsidiary	Ukraine
Gas supply company Naftogaz of Ukraine, LLC	100.00	100.00	Subsidiary	Ukraine
Gas supply company Naftogaz Trading, LLC	100.00	100.00	Subsidiary	Ukraine
Naftogaz Trading Europe AG	100.00	100.00	Subsidiary	Switzerland
Kirovogradgaz, OJSC	51.00	51.00	Subsidiary	Ukraine
Ukravtogaz, SE	100.00	100.00	Subsidiary	Ukraine

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: 4.1%) with slight devaluation of national currency by around 4.4% to USD and 6.4% to EUR comparing to previous year averages.

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 its discount rate for the first time during the recent two years, from 18.0% in April 2019 to 11.0% in January 2020, and further decrease down to 6.5% starting from March 2021.

The degree of macroeconomic 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 enabled the immediate disbursement of the equivalent of about USD 2.1 billion.

Fitch’s current rating of Ukraine’s Long-Term Foreign- and Local-Currency Issuer Default Ratings was stated as “B”, revised from positive to stable outlook in April 2020.

Impact of COVID-19

In late 2019, news first emerged from China about the COVID-19 (Coronavirus). In early 2020 the virus spread globally and its negative impact gained momentum. The global spread of COVID-19 created significant volatility, uncertainty, and economic disruption during 2020. 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 business and government shutdowns. State and local authorities have also implemented multi-step policies with the goal of re-opening. However, certain jurisdictions began re-opening only to return to restrictions in the face of increases in new COVID-19 cases. The Group has taken certain precautionary measures intended to help minimize the risk to its employees, the business and the communities in which it operates, including organising remote workplaces and providing personal protective equipment to its employees, and supplying medical equipment and personal protective equipment worth more than UAH 500 million at the Group’s cost to hospitals across Ukraine. However, management cannot guarantee that any actions taken by the Group will be effective in preventing future disruptions to the Group’s business.

Management assesses that the situation might potentially result in inability or unfavourable pricing 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 and to 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 governmental authorities, 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.

Gas market in Ukraine

The natural gas market of Ukraine is based on the principles of free and fair competition. The State does not interfere to the operations on the market, except when it is necessary to eliminate market constraints or to insure public interest, taking that actions by the State are carried at a minimum sufficient level. Prices for a natural gas supply should be defined between the supplier and the customer on an arm’s length, except for the certain cases when the Cabinet of Ministers of Ukraine (“CMU”) imposes public service obligations (“public service obligations” or “PSO”) on the Company in respect of certain groups of customers, mainly households. The currently effective rules of the PSO are described in the Resolution #867 dated 19 October

2018 “On Approval of the Provisions for Imposing Special Obligations on the Natural Gas Market Participants for Ensuring Public Interests in the Natural Gas Market Functioning”, covering the period from 1 November 2018 to 1 May 2021 (“Resolution #867”).

Further in April-May 2019, with the Resolutions #293 and #380, the Cabinet of Ministers of Ukraine changed a mechanism of the gas price setting within the PSO, switching to the lower of:

- the average price of natural gas for industrial consumers for the previous month supplied on a prepaid basis;
- the average customs value of imported natural gas for the previous month, published by the Ministry of Economic Development and Trade;
- the average month-ahead selling price of natural gas according to the results of electronic stock exchange, or
- the price of natural gas set in the Resolution #867.

On 24 January 2020, the Cabinet of Ministers of Ukraine changed a mechanism of the gas price setting within the PSO from 1 January 2020 by Resolution #17. Under the new formula, the wholesale price of natural gas for the current month will include the weighted average price for natural gas for the next gas delivery day on a Dutch gas hub (TTF) for the period 1-22 day of the gas supply month, the difference (spread) between the price on TTF hub and Ukrainian border, tariff for natural gas transportation services at interstate connections and trade margin. For customers outside the PSO, imported natural gas is sold under the prices set by the gas market participants. The prices for natural gas set by the Group are differentiated based on the monthly consumption volumes and payment method by the customer.

On 24 April 2020, the public service obligations were extended until 1 July 2020 for the needs of households and religious organizations, and until 1 May 2021 for heat generating companies. Further in June 2020, with the Resolution #542, the Cabinet of Ministers of Ukraine extended the public service obligations for the needs of households until 31 July 2020.

The Company’s public service obligations in respect of gas sales for the needs of households and religious organizations were terminated starting from 1 August 2020.

Compensation for performing public service obligations

In accordance with Para 7, Article 11 of the Law of Ukraine “On Natural Gas Market”, a gas market player with public service obligations is eligible for compensation of economically justified expenditures incurred by such player, less any income obtained in the course of fulfilling such obligations plus adequate profit margin.

Procedure to receive compensation was not set up before 2020, and the Company took all measures possible to defend its right for such compensation, including claims to courts.

Accordingly, in May 2017 the Company submitted two claims against the Cabinet of Ministers of Ukraine to admit the failure of the latter to identify sources of financing and procedure to receive the compensation for performing public service obligations for the Company as a gas market player with public service obligations. One of the above claims was decided in favour of the Company in all court instances. Another claim is heard in the court of cassation upon respective cassation claim of the Cabinet of Ministers of Ukraine as at the date of these consolidated financial statements. Additionally, in October 2019

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020

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 procedure to receive the compensation for performing public service obligations for the Company as a gas market player with public service obligations, and it was also decided 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 amounts 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 amounts 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 Luhanska and Donetska 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 measures 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 19,002 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 maximize the value of the Group.

In 2020, as part of organisational transformation of the Group, Integrated gas segment was split 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, oil and gas condensate production, performed by "UkrGasvydobuvannya" 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 supply 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.

Management identified four main groups of customers in respect of gas sales and supply:

- 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 setting for gas sales to RSC, MHE for the needs of households and to the other customers under PSO is performed within the current PSO Resolution (Note 2). Gas supply for other groups of customers is performed at prices established independently by Naftogaz.

Oil midstream and downstream. This segment includes activities related to transportation, sale and supply of oil, gas condensate, petroleum products, and related services.

The Group sells purchased and domestically refined petroleum products through filling stations network throughout Ukraine. Domestic refinery of petroleum products is performed at oil and gas refineries controlled by the Group. Oil transit and transmission operations are presented by oil transmission pipelines and 11 oil reservoirs operated by the Group.

Gas transit organisation services. At the end of 2019 the Company and "Gazprom" JSC signed an agreement on servicing 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 transportation 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.

"Ukrnafta" PJSC. "Ukrnafta" PJSC is the biggest oil producing company in Ukraine. "Ukrnafta" PJSC 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.

"Ukrnafta" PJSC also owns one of the largest filling stations network in Ukraine located in different regions of Ukraine.

Other. Other segments include results of joint operations 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 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. Respective reconciliations 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020

Segment information for the reportable business segments of the Group for the year ended 31 December 2020 is as follows:

<i>In millions of Ukrainian hryvnias</i>	Exploration and production	Oil midstream and downstream	Commercial	Gas storage	Ukrnafta	Gas transit organisation services	Other	Elimi- nation	Total
Sales – external	18	10,666	74,750	2,864	22,973	46,724	1,239	-	159,234
Sales to other segments	55,857	835	726	2,283	12,562	-	618	(72,881)	-
Total revenue	55,875	11,501	75,476	5,147	35,535	46,724	1,857	(72,881)	159,234
Segment adjusted EBITDA	27,990	2,052	(15,718)	3,285	9,628	1,722	(5,596)	-	23,363
Segment assets	105,508	18,777	59,091	69,405	26,111	4,455	12,850		296,197
Capital expenditure	11,023	1,185	133	143	1,113	-	1,448		15,044
Segment operating cash flows before working capital changes	29,384	2,254	18,527	3,934	12,450	1,747	(2,013)	-	66,283
Material non-cash items included in segment results:									
Net movement in provision for financial assets	(11)	(2)	(34,295)	64	(3,341)	-	(2,181)		(39,766)
Material non-cash items excluded from segment results:									
Depreciation, depletion and amortisation	(12,478)	(785)	(149)	(527)	(2,498)	-	(111)		(16,548)
Net impairment losses	(4,801)	(18)	65	-	(806)	-	(2,268)		(7,828)

Segment information for the reportable business segments of the Group for the year ended 31 December 2019 is as follows:

<i>In millions of Ukrainian hryvnias</i>	Exploration and production	Oil midstream and downstream	Commercial	Gas storage	Ukrnafta	Other	Elimination	Total
Sales – external	3	11,931	108,584	727	28,161	375	-	149,781
Sales to other segments	77,862	963	462	2,535	49	210	(82,081)	-
Total revenue	77,865	12,894	109,046	3,262	28,210	585	(82,081)	149,781
Segment adjusted EBITDA	43,693	1,585	(9,610)	1,525	(1,251)	(4,769)	-	31,173
Segment assets	120,911	17,351	99,086	79,498	33,228	11,416		361,490
Capital expenditure	14,946	1,833	12	44	1,445	8,957		27,237
Segment operating cash flows before working capital changes	45,310	1,857	(6,714)	1,009	5,015	(2,144)	-	44,333
Material non-cash items included in segment results:								
Write down of inventories	(213)	(19)	(658)	27	(181)	(145)		(1,189)
Net movement in provision for financial assets	44	4	(1,943)	8	(3,251)	(1,324)		(6,470)
Material non-cash items excluded from segment results:								
Depreciation, depletion and amortisation	(10,999)	(688)	(91)	(873)	(1,555)	(2)		(14,208)
Net impairment losses	(5,978)	(152)	27	(386)	(678)	(2,257)		(9,424)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020

Reconciliations

The following tables include reconciliations of segment information to the aggregate numbers of the consolidated Segment result

In millions of Ukrainian hryvnias

	2020	2019
Segment adjusted EBITDA	23,363	31,173
Depreciation, depletion and amortisation	(16,548)	(14,208)
Impairment loss	(7,950)	(9,424)
Change in provisions for litigations and other provisions	(554)	624
Interest and other income	1,578	2,052
Finance costs	(6,738)	(6,377)
Share of after-tax results of associates	(65)	(121)
Net foreign exchange income	1,545	1,937
Unallocated expense, net	(8,673)	(765)
(Loss)/profit before tax from continuing operations	(14,042)	4,891

Unallocated expense in 2020 include net movement in provision for receivables for balancing services that are no longer attributable to any of the reporting segments, certain provisions for litigations, non-recoverable VAT, charity and other

financial statements, taking into account items which are not directly attributable to a segment

expense that are are not directly attributable to any segment.

	31 December 2020	31 December 2019
Segment assets	296,197	361,490
Deferred tax assets	7,685	10,439
Investments in associates and joint ventures	772	835
Cash and bank balances	37,106	77,593
Consideration receivable under the SPA	81,058	-
State treasury bonds	11,483	-
Assets of discontinued operations classified as held for sale and distribution	-	115,355
Prepaid corporate income tax	10,080	-
Unallocated assets	1,610	14,868
Total assets	445,991	580,580

Net cash generated by/(used in) operating activities

In millions of Ukrainian hryvnias

	2020	2019
Segment operating cash flows before working capital changes	66,283	44,333
Working capital and other changes	(18,251)	(22,051)
Income taxes paid	(23,245)	(14,207)
Operating cash flows from discontinued operations (Note 20)	-	101,690
Unallocated cash flows from operating activities	(5,337)	(1,173)
Net cash generated by operating activities	19,450	108,592

Geographical concentration of sales

In millions of Ukrainian hryvnias

	2020	2019
Ukraine	104,266	143,168
Russian Federation	49,910	3,377
Europe	4,837	2,868
Egypt	209	354
USA	12	14
Total revenue	159,234	149,781

Allocation of sales in the table above is made based on the country of residence of the Group's customers.

External customers concentration, exceeding 10% of total revenues

During the years ended 31 December 2020 and 2019, the only external customer with concentration of revenue exceeding 10% of total revenues was Gazprom. Amount of revenue from Gazprom related to gas transit organisation services in 2020 amounted to UAH 46,724 million (2019: revenues related to gas transit in amount of UAH 70,204 million included in discontinued operations).

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 or joint control 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.

Balances with related parties were as follows:

	31 December 2020	31 December 2019
Trade accounts receivable	32 %	45 %
Advances received and other current liabilities	38 %	44 %
Cash and bank balances	98 %	99 %
Provisions	16 %	43 %
Bank borrowings	29 %	38 %
Prepayments made and other current assets	96 %	60 %

Transactions with related parties for the period were as follows:

	31 December 2020	31 December 2019
Revenue	26 %	31 %
Interest income on bank balances	99 %	99 %
Interest expense	37 %	70 %

Information on transactions with the State is futher disclosed in Note 2 (Compensation for performing public service obligations), Note 10, Note 11 and Note 20.

Pledges.

As at 31 December 2020 and 2019, borrowings from related parties (State-owned banks) were secured by property, plant and equipment, inventories and proceeds from future sales (Note 12). As at 31 December 2020, about 91% of pledges were related to the borrowings from State-owned banks (31 December 2019: 71%).

Guarantees.

Amount of guarantees, provided by the Government of Ukraine, as at 31 December 2020 and 2019 equalled to UAH 2,783 million and UAH 2,694 million, respectively (Note 12).

Key management remuneration. During 2020 key management personnel consisted on average of 5 Executive Board members and 12 directors (2019: 5 Executive Board members and 11 directors). Compensation to the key management personnel included in selling, general and administrative expenses consists of salary and additional current bonuses and comprises UAH 672 million in 2020 (2019: UAH 343 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.

Transactions with related parties are performed on terms that would not necessarily be available to unrelated parties.

Transactions with state-controlled entities and institutions.

The Group performs significant transactions with entities and institutions controlled, jointly controlled or significantly influenced by the Government of Ukraine. These entities and institutions include State Savings Bank of Ukraine, Ukreximbank, Ukrgazbank, tax authorities, municipal heat generating entities and other entities.

In 2020, the Group purchased and sold the state treasury bonds of Ukraine amounted to UAH 34,832 million and UAH 22,562 million, respectively.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020

5. PROPERTY, PLANT AND EQUIPMENT

Movements in the carrying amount of property, plant and equipment were as follows:

<i>In millions of Ukrainian hryvnias</i>	Exploration, evaluation and drilling assets	Gas and oil upstream	Gas transmission system	Underground gas storages	Cushion gas
Net book value at 31 December 2018	4,241	95,021	85,913	12,573	186,497
Cost or valuation	5,014	106,649	188,162	13,829	186,497
Accumulated depreciation and mpairment	(773)	(11,628)	(102,249)	(1,256)	-
Additions and transfers	7,646	14,378	761	(1,078)	-
Revaluation	(1,530)	6,571	38,062	(3,736)	(117,257)
Disposals	(14)	(134)	69	-	-
epreciation charge	(1,212)	(12,293)	(19,747)	(990)	-
Impairment	(65)	(57)	-	-	-
Reclassification to assets of discontinued operations classified as held for sale and distribution	-	-	(105,058)	-	-
Net book value at 31 December 2019	9,066	103,486	-	6,769	69,240
Cost or valuation	9,411	106,843	-	6,785	69,240
Accumulated depreciation and impairment	(345)	(3,357)	-	(16)	-
Additions and transfers	1,921	15,256	-	218	-
Disposals	(36)	(128)	-	-	-
Depreciation charge	(1,412)	(14,751)	-	(436)	-
Impairment/revaluation	(81)	(11,909)	-	-	(9,739)
Net book value at 31 December 2020	9,458	91,954	-	6,551	59,501
Cost or valuation	11,190	122,885	-	7,284	59,501
Accumulated depreciation and impairment	(1,732)	(30,931)	-	(733)	-

The Group engaged independent appraisers to determine the fair value of its major groups of property, plant and equipment as at 1 October 2019, and as at 1 December 2020 for “Oil transmission system”. The fair value was determined in accordance with International Valuation Standards. Taking into account the nature of the Group’s property, plant and equipment, fair value was determined using depreciated replacement cost for specialised assets, and using market-based evidence for non-specialised assets. The fair value of main producing properties and equipment was primarily determined using depreciated replacement cost. This method considers the cost to reproduce or replace the property, plant and equipment, adjusted for physical, functional and economic depreciation, and obsolescence. The depreciated replacement cost was estimated based on internal sources and analysis of available market information for similar property, plant and equipment (published information, catalogues, statistical data etc), and information from industry experts and suppliers.

As at 31 December 2020, the Group engaged independent appraisers to perform the reassessment of difference between the carrying value and fair value of major cash generated units using discounted cash flow method. Expected cash flows have been determined on the basis of forecasts and assumptions as of the date of these consolidated financial statements. Forecasts and assumptions were based on market information, historical data, macroeconomic expectations, forecasts for the subsequent activity of the cash generating units (Note 23).

Furthermore, management of the Group has assessed whether there has been a material change in the underlying fair value drivers at 31 December 2020 as compared to the fair values of “Underground gas storages” recorded at 31 December 2019. As a result of this assessment, management of the Group has concluded that there is no need to update the fair values as it was determined that there would not be a material impact on the statement of profit and loss of the Group.

As a result of this assessment, the management came to the conclusion that the recoverable value of certain cash generating

Oil transmission system	Gas and oil refinery	Filling stations	Gas distribu- tion assets	LNG transpor- tation	Other fixed assets	Construction in progress	Total
8,658	2,697	4,306	152	147	3,639	30,526	434,370
14,571	3,025	4,659	187	189	8,262	32,806	563,850
(5,913)	(328)	(353)	(35)	(42)	(4,623)	(2,280)	(129,480)
653	1,193	107	12	9	2,720	6,178	32,579
(553)	861	(270)	-	366	-	-	(77,486)
-	(4)	(1)	-	-	(189)	(978)	(1,251)
(577)	(349)	(230)	(9)	(17)	(623)	-	(36,047)
-	(8)	-	-	-	28	(3,136)	(3,238)
-	-	-	-	-	(113)	(3,250)	(108,421)
8,181	4,390	3,912	155	505	5,462	29,340	240,506
8,330	4,514	3,974	198	518	9,978	34,666	254,457
(149)	(124)	(62)	(43)	(13)	(4,516)	(5,326)	(13,951)
116	227	133	9	26	(429)	(221)	17,256
-	(3)	(2)	-	-	(35)	(1,384)	(1,588)
(568)	(446)	(239)	(63)	(33)	(477)	-	(18,425)
590	(46)	(783)	533	-	(1,421)	(3,759)	(26,615)
8,319	4,122	3,021	634	498	3,100	23,976	211,134
8,389	4,735	4,104	697	542	8,763	32,862	260,952
(70)	(613)	(1,083)	(63)	(44)	(5,663)	(8,886)	(49,818)

units was lower than their carrying amount and, accordingly, recognised valuation decrease in value of property, plant and equipment in amount of UAH 7,154 million in net impairment losses (2019: UAH 9,261 million was charged from continuing operations and UAH 812 million from discontinued operations) and in amount of UAH 19,461 million in other comprehensive loss (2019: UAH 70,651 million).

In 2020, the depreciation and depletion expenses of UAH 16,132 million (2019: UAH 12,945 million) were presented in a separate line of the consolidated statement of profit or loss (2019: UAH 13,890 million), UAH 1,929 million (2019: UAH 1,831 million) were capitalised in the cost of property, plant and equipment, UAH 364 million were capitalised in cost of inventories (2019: UAH 95 million), and UAH 20,231 million were charged by discontinued operations in 2019.

As at 31 December 2020 and 2019, the Group has pledged its property, plant and equipment with carrying amount of UAH 3,134 million and UAH 84 million, respectively, to secure its borrowings (Note 12).

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:

	31 December 2020	31 December 2019
<i>In millions of Ukrainian hryvnias</i>		
Investments in associates	767	820
Investments in joint ventures	5	15
Total	772	835

Details of each of the Group’s associates and joint ventures as at 31 December 2020 are as follows:

Name of associate/ joint ventures	Principal activity	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	Construction works	Ukraine	40.2 %	-	(53)	-	-	-	-	767
“Ukratnafta” PJSC	Oil refinery	Ukraine	43.05 %	-	-	-	-	-	-	-
Other	Miscellaneous	Ukraine	miscellaneous		(12)	-	-	2	-	5
				-	(65)	-	-	2	-	772

Details of each of the Group’s associates and joint ventures as at 31 December 2020 are as follows:

Name of associate/ joint ventures	Principal activity	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 loss	Provision for impairment	Carrying ammount
“Gaztransit” PJSC	Construction works	Ukraine	40.2 %	-	(74)	137	(4)	(134)	-	820
“Ukratnafta” PJSC	Oil refinery	Ukraine	43.05 %	-	(42)	4	-	-	(295)	-
Other	Miscellaneous	Ukraine	miscellaneous	2	(5)	-	-	(1)	-	15
				2	(121)	133	(4)	(135)	(295)	835

All of the above associates are accounted for using the equity method in these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020

7. OTHER NON-CURRENT ASSETS

The Group’s other non-current assets were as follows:

	31 December 2020	31 December 2019
<i>In millions of Ukrainian hryvnias</i>		
Accounts receivable on product sharing agreement	5,250	4,504
Intangible assets	3,333	3,101
Restructured accounts receivable of gas consumers	2,146	2,979
Other	2,371	2,730
Less: provision for impairment	(7,061)	(4,809)
Total	6,039	8,505

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 2020 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” #3319-VI 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 14% to 15% per annum.

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” #1730 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 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 agreement.

Other. As at 31 December 2020 and 2019, included in other non-current assets are research and development expenditures amounting to UAH 1,080 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).

Movements in provision for impairment of non-current accounts receivable were as follows:

	2020	2019
<i>In millions of Ukrainian hryvnias</i>		
Balance at 1 January	3,268	2,202
Provision for impairment recognised during the year	2,158	1,299
Reversal of provision for impairment	-	(211)
Other movements	(20)	(22)
Balance at 31 December	5,406	3,268

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.

8. INVENTORIES

The Group’s inventories were as follows:

	31 December 2020	31 December 2019
<i>In millions of Ukrainian hryvnias</i>		
Natural gas	30,521	45,847
Crude oil	3,639	3,492
Petroleum products	2,243	3,516
Spare parts	1,964	2,303
Raw materials	1,169	1,349
Other	1,155	1,198
Total	40,691	57,705

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 was 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).

9. TRADE ACCOUNTS RECEIVABLE

The Group’s trade accounts receivable were as follows:

	31 December 2020	31 December 2019
<i>In millions of Ukrainian hryvnias</i>		
Accounts receivable for natural gas	86,202	73,436
Accounts receivable for gas balancing services	43,622	44,059
Accounts receivable for petroleum products	12,909	10,987
Accounts receivable for crude oil	6,251	7,740
Accounts receivable for gas transportation services	3,347	8,504
Other accounts receivable	3,244	2,608
Less: provision for impairment	(127,446)	(88,278)
Total	28,129	59,056

Movements in provision for impairment of trade accounts receivable were as follows:

	2020	2019
<i>In millions of Ukrainian hryvnias</i>		
Balance at 1 January	88,278	69,775
Provision for impairment recognised during the period	55,320	22,965
Reversal of provision for impairment	(16,338)	(17,574)
Amounts written off as uncollectible	(306)	(1,735)
Provision recognised from discontinued operations	-	15,199
Other movements	492	(352)
Balance at 31 December	127,446	88,278

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 PSO 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:

31 December 2020							
In millions of Ukrainian hryvnias	Trade accounts receivable - days past due						
	Not past due	1 - 90	91 - 180	181 - 270	271 - 365	> 365	Total
Gross carrying amount	20,560	7,548	5,516	8,240	19,847	93,864	155,575
Provision for impairment	(2,940)	(2,316)	(3,812)	(6,825)	(18,008)	(93,545)	(127,446)
Expected credit loss rate, %	14 %	31%	69%	83%	91%	100%	

31 December 2019							
In millions of Ukrainian hryvnias	Trade accounts receivable - days past due						
	Not past due	1 - 90	91 - 180	181 - 270	271 - 365	> 365	Total
Gross carrying amount	27,832	17,208	4,321	17,028	18,001	62,944	147,334
Provision for impairment	(4,680)	(3,207)	(1,415)	(5,231)	(11,363)	(62,382)	(88,278)
Expected credit loss rate, %	17%	19%	33%	31%	63%	99%	

10. PREPAYMENTS MADE AND OTHER CURRENT ASSETS

The Group’s prepayments made and other current assets were as follows:

In millions of Ukrainian hryvnias	31 December 2020	31 December 2019
Financial assets:		
State treasury bonds of Ukraine	11,483	-
Receivables under assignation agreements in respect of natural gas sales	1,518	1,497
Promissory notes receivable	1,427	1,429
Other financial assets	5,804	4,690
Less: Provision for impairment of financial assets	(6,870)	(5,911)
Total financial assets	13,362	1,705
Non-financial assets:		
Prepayments to suppliers for materials, works and services	8,166	7,242
Prepayment for gas transit services	3,614	-
VAT recoverable	3,279	2,372
Prepayments for pipelines construction	1,342	1,346
Taxes prepaid, other than income tax	201	858
Prepayments to suppliers for natural gas	158	3,007
Other non-financial assets	4,163	5,079
Less: Provision for impairment of non-financial assets	(11,644)	(11,722)
	9,279	8,182
Total non-financial assets	22,641	9,887
Total		

Movements in the provision for impairment were as follows:

In millions of Ukrainian hryvnias	2020	2019
Balance at 1 January	17,633	17,284
Provision for impairment recognised during the period	2,020	213
Reversal of provision for impairment	(565)	(221)
Amounts written off as uncollectible	(304)	(127)
Other movements	(270)	484
Balance at 31 December	18,514	17,633

Movements in provision for impairment mainly relate to financial assets. Other movements in provision for impairment relate to reclassification of provision between current and non-current accounts receivable and to the difference in proportion

of assets and profits consolidation related to joint ventures of one of the Group's subsidiaries, recognised in equity movement.

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 190,150 million, comprising 190,150,481 ordinary shares, with a par value of UAH 1,000 per share.

Also, as at 31 December 2020 and 2019, share capital of the Company has been adjusted for the effect of hyperinflation in accordance with IAS 29 “Financial Reporting in Hyperinflationary Economies” by UAH 4,157 million. Therefore the total amount of share capital of the Company as at 31 December 2020 and 2019 was UAH 194,307 million.

Distribution of profits.

Profit available for distribution to the shareholders for each reporting period is determined by reference to the stand alone financial statements of the Company prepared in accordance with International Financial Reporting Standards (IFRS). Under Ukrainian legislation, the amount of dividends is limited to net profit of the reporting period or other distributable reserves but not more than retained earnings as per the stand alone financial statements prepared in accordance with IFRS. The Company has to make a decision in respect of dividend distribution by 30 April and to pay the dividend to the State budget by 30 June of the year in the following reporting year. The Cabinet of Ministers of Ukraine approves a percentage of net profit to be distributed each year with a separate resolution. If there is no such resolution available by 30 June, the Company is obliged to distribute 30% of its net profit to the State budget of Ukraine, as set by provisions of the Law of Ukraine “On Management of State Property Objects” #185-V dated 21 September 2006. The Company’s policy is to accrue a provision in respect of minimum obligatory dividend distribution level of 30% of its net profit.

According to the Resolutions of the Cabinet of Ministers of Ukraine #461-r dated 24 April 2019, 90% of the net profit of the Company for 2018 amounting to UAH 12,252 million was distributed as dividends. However, the abovementioned

resolution was 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 State 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 8,500 million out of this amount in December 2019 as dividends per results of 2019. In accordance 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" PJSC attributable to the State Budget of Ukraine (UAH 1,921 million) and other equity holders (UAH 1,921 million) in current provisions (Note 13).

12. BORROWINGS

The Group’s borrowings were as follows:

In millions of Ukrainian hryvnias	31 December 2020	31 December 2019
Non-current		
Eurobonds	44,453	35,631
Bank borrowings	12,220	11,689
Unamortised discount	(126)	(172)
Total non-current portion	56,547	47,148
Current		
Bank borrowings	8,427	12,178
Interest accrued	1,368	1,336
Total current portion	9,795	13,514
Total	66,342	60,662

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:

In million of Ukrainian hryvnias	Coupon rate, %	Date of maturity	Nominal value in million	Currency	Carrying amount	
					31 December 2020	31 December 2019
Issue of July 2019 (Tranche A)	7.125	July 2024	600	Euro	20,802	15,800
Issue of July 2019 (Tranche B)	7.375	July 2022	335	US dollars	9,457	7,910
Issue of November 2019	7.625	November 2026	500	US dollars	14,124	11,828
					44,383	35,538

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:

In millions of Ukrainian hryvnias	31 December 2019		31 December 2019	
	Balance	% per annum	Balance	% per annum
US dollars	32,640	7.6	24,605	8.1
Euro	24,405	7.3	16,982	7.6
UAH	9,297	12.1	19,075	17.4
Total	66,342		60,662	

PLEDGES

The Group’s borrowings were secured by the following pledges:

In millions of Ukrainian hryvnias	31 December 2020	31 December 2019
Inventories (Note 8)	17,323	30,984
Proceeds from future sales	14,412	17,588
Property, plant and equipment (Note 5)	3,134	84
Total	34,869	48,656

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).

Reconciliation of financial liabilities from financing activities

In millions of Ukrainian hryvnias	31 December 2019	Cash flows from financing activities	Non-cash transactions	Interest expense (Note 18)	31 December 2020
Bank borrowings	24,169	(7,706)	1,847	2,441	20,751
Eurobonds	36,493	(3,174)	9,099	3,173	45,591
Total	60,662	(10,880)	10,946	5,614	66,342

In millions of Ukrainian hryvnias	31 December 2018	Cash flows from financing activities	Non-cash transactions	Interest expense (Note 18)	31 December 2019
Bank borrowings	55,999	(34,893)	(1,521)	4,584	24,169
Eurobonds	-	38,495	(2,987)	985	36,493
Total	55,999	3,602	(4,508)	5,569	60,662

Non-cash transactions relate to foreign exchange differences on borrowings.

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:

	Provisions for litigations	Employee benefit obligations
<i>In millions of Ukrainian hryvnias</i>		
Balance at 31 December 2018	15,254	6,501
Provision for dividends payable to the State Budget (Note 11)	-	-
(Reversed)/Charged during the year	(1,367)	2,265
Unwinding of discount	-	635
Used or paid during the year	(1,283)	(2,374)
Remeasurements	-	1,133
Reclassification to liabilities of discontinued operations classified as held for sale and distribution	-	(195)
Balance at 31 December 2019	12,604	7,965
Non-current	-	5,205
Current	12,604	2,760
Provision for dividends payable to the State Budget and other equity holders (Note 11)	-	-
Charged/(reversed) during the year	3,419	2,747
Unwinding of discount	-	492
Used or paid during the year	(13,433)	(2,438)
Remeasurements	-	(717)
Balance at 31 December 2020	2,590	8,049
Non-current	-	4,671
Current	2,590	3,378

Decommissioning provision	Provision for fines and penalties	Portion of net profit attributable to the State Budget of Ukraine and other equity holders (Note 11)	Other provisions	Total
2,604	16,661	4,084	1,928	47,032
-	-	15,197	-	15,197
534	2,592	-	(452)	3,572
221	-	-	-	856
(4)	-	(12,584)	(6)	(16,251)
2,085	-	-	-	3,218
-	-	-	-	(195)
5,440	19,253	6,697	1,470	53,429
5,383	-	-	-	10,588
57	19,253	6,697	1,470	42,841
-	-	3,842	-	3,842
(1)	(791)	-	779	6,153
362	-	-	-	854
(106)	(16,820)	(6,697)	(185)	(39,679)
(453)	-	-	-	(1,170)
5,242	1,642	3,842	2,064	23,429
5,182	-	-	-	9,853
60	1,642	3,842	2,064	13,576

The principal actuarial assumptions used were as follows:

	2020	2019
Nominal discount rate, %	9.6-10.0	9.2-9.5
Long-term inflation, %	4.8	5.0-6.5
Nominal salary increase rate, %	4.8-15.0	5.0-16.0
Staff turnover ratio, %	1.5-10.0	1.2-8.6

The sensitivity of the non-current employee benefit obligations to changes in the principal assumptions is as follows:

	2020	2019
Nominal discount rate	(7.81)/9.04	(8.37)/9.77
increase/decrease by 1%, %		
Nominal salary	5.29/(4.73)	7.24/ 6.45)
increase/decrease by 1%, %		
Staff turnover increase/decrease by 1%, %	(1.97)/2.53	(2.83)/2.90

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 from prior years.

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 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

provision in amount of UAH 7,164 million.

In 2020 several court decisions resulted in final approval of the Settlement Agreement between Misen Enterprises AB, “Karpatygas” LLC and the Group. As a result, the Group accrued and used a respective provision of UAH 1,337 million (Note 21).

Other movements in provisions used represent amounts of liabilities on taxes and royalty charges in the total amount of UAH 4,514 million.

Employee Benefit Obligations

The Group companies have certain obligations to its employees according to the collective agreements.

Current provisions for employee benefits include provision for performance bonuses.

Non-current provisions for employee benefits include lump sum benefits payable upon retirement and post-retirement benefit programs. These benefits plans are not funded, and there are no plan assets.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020

Decommissioning Provision		
In accordance with the legislation requirements, the Group is obliged to restore the lands that underwent changes in the relief structure, environmental state of soils and parent rocks, as well as hydrological regime due to drilling, geological survey, constructing and other works. The decommissioning provision represents present value of decommissioning costs relating to oil and gas properties.		
The principal assumptions used for determining the amount of provision for decommissioning of non-current assets were as follows:		
	2020	2019
Discount rate before tax, %	9.7-9.8	9.1-9.3
Long-term inflation rate, %	4.8-5.4	5.0-5.3
<p>As at 31 December 2020, the Group has revised calculation of provisions for decommissioning of non-current assets to reflect its current best estimate. As a result, there was an decrease in the amount of provision, which is mainly related to the increase of discount rate.</p> <p>Provision for fines and penalties</p> <p>As a result of non-payment and late payment by “Ukrnafta” PJSC of subsoil royalty, income tax and VAT, the Group accrued provision for fines, penalties and late payment interest in respect of such tax liabilities. In 2020, the Group used the provision in amount of UAH 16,820 and settled its fines and penalties to the state budget (Note 2).</p>		

14. ADVANCES RECEIVED AND OTHER CURRENT LIABILITIES

The Group’s advances received and other current liabilities were as follows:

<i>In millions of Ukrainian hryvnias</i>	31 December 2020	31 December 2019
Financial liabilities:		
Liabilities for purchase of property, plant and equipment	2,281	2,246
Other financial current liabilities	1,849	1,148
Total financial liabilities	4,130	3,394
Non-financial liabilities:		
VAT payable	3,826	2,111
Taxes payable other than income tax	2,552	8,891
Wages, salaries and related social charges payable	514	429
Dividends payable to non-controlling shareholders of "Ukrnafta" PJSC	427	428
Recognised liabilities for litigations	177	186
Other non-financial current liabilities	808	1,450
Advances for natural gas	3,324	1,559
Advances for gas transit organisation services	2,673	-
Advances for oil transportation	284	278
Advances received for geophysical surveys	177	185
Advances for petroleum products	173	130
Other advances received	1,212	453
	16,147	16,100
Total non-financial liabilities	20,277	19,494
Total		

As at 31 December 2020, taxes payable other than income tax included UAH 2,387 million of subsoil royalty payable (31 December 2019: UAH 8,596 million).

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 25).

<i>In millions of Ukrainian hryvnias</i>	2020	2019
Subsoil royalty and other taxes other than on income	25,924	32,873
Staff costs and related social charges	7,596	6,427
Transportation of oil and natural gas	3,130	2,544
Crude oil processing services	3,022	2,263
Repair and maintenance costs	2,605	2,360
Materials	2,007	4,282
Utilities	1,541	1,130
Other	2,397	1,991
Total	48,222	53,870
Subsoil royalty and rent tax are calculated with reference to the volume of crude oil, gas condensate or natural gas produced, and volume of crude oil transportation.		

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 25).

<i>In millions of Ukrainian hryvnias</i>	2020	2019
Gas transit organisation services (Note 25)	44,858	-
Gas	16,706	35,772
Oil and petroleum products	2,813	4,986
Write-off of purchased inventories to net realizable value	-	679
Other	181	152
Total	64,558	41,589

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 25).

<i>In millions of Ukrainian hryvnias</i>	2020	2019
Staff costs and related social charges	8,149	7,037
Non-refundable VAT	4,747	937
Professional fees	948	1,220
Charity and social infrastructure	788	137
Change in provisions for litigations and other provisions	624	1,783
Transportation costs	509	356
Loss on disposal of property, plant and equipment and intangible assets	442	861
Court fees and charges	400	1,399
Write-down of inventories to net realisable value	96	540
Other	4,637	1,745
Total	21,340	16,015

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).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020

18. FINANCE COSTS

In millions of Ukrainian hryvnias

	2020	2019
Interest expense on borrowings	5,614	5,464
Unwinding of discount	1,011	909
Other	113	4
Total	6,738	6,377

19. INCOME TAX

The components of income tax expense from continuing operations for the years ended 31 December were as follows:

In millions of Ukrainian hryvnias

	2020	2019
Current tax expense	4,789	6,132
Deferred tax expense/(benefit)	171	(3,822)
Income tax expenses	4,960	2,310

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:

In millions of Ukrainian hryvnias

	2020	2019
(Loss)/Profit before income tax	(14,042)	4,891
Income tax (benefit)/expense at statutory rate of 18%	(2,528)	880
Effect of changes in tax legislation	344	229
Tax effect of items not deductible or taxable for taxation purposes:		
- Non-deductible expenses	3,892	2,378
- Non-taxable income	(933)	(1,045)
Change in unrecognised deferred tax asset	4,185	(132)
Income tax expenses	4,960	2,310

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:

	31 December 2020	31 December 2019
Deferred tax assets	7,685	10,439
Deferred tax liabilities	(12,910)	(18,858)
Net deferred tax liability	(5,225)	(8,419)

Net deferred tax liabilities as at 31 December 2020 related to the following:

<i>In millions of Ukrainian hryvnias</i>	31 December 2019	Recognised in profit or loss	Recognised in other comprehensive income	31 December 2020
Property, plant and equipment	(18,932)	3,141	3,572	(12,219)
Trade accounts receivable	916	1,326	-	2,242
Advances received and other current liabilities	58	6	-	64
Provisions	7,403	(5,289)	(207)	1,907
Inventories	1,452	(737)	-	715
Prepayments made and other current assets	659	(493)	-	166
Other non-current assets	18	64	-	82
Unused tax losses	7	1,811	-	1,818
Net deferred tax liability	(8,419)	(171)	3,365	(5,225)

Net deferred tax liabilities as at 31 December 2019 related to the following:

<i>In millions of Ukrainian hryvnias</i>	31 December 2018	Recognised in profit or loss from continuing operations	Recognised in profit or loss from discontinued operations	Recognised in other comprehensive income	Reclassified to liabilities of discontinued operations classified as held for sale and distribution	31 December 2019
Property, plant and equipment	(55,520)	3,725	3,587	12,722	16,554	(18,932)
Trade accounts receivable	386	530	-	-	-	916
Advances received and other current liabilities	85	(27)	-	-	-	58
Provisions	7,200	(118)	(167)	488	-	7,403
Inventories	1,860	(408)	-	-	-	1,452
Prepayments made and other current assets	564	95	-	-	-	659
Other non-current assets	-	18	-	-	-	18
Unused tax losses	-	7	-	-	-	7
Net deferred tax liability	(45,425)	3,822	3,420	13,210	16,554	(8,419)

As at 31 December 2020 and 2019, unrecognised deductible temporary differences and unused tax losses are as follows:

<i>In millions of Ukrainian hryvnias</i>	31 December 2020	31 December 2019
Provisions		
Trade accounts receivable, prepayments made, other non-current and current assets	1,027	45,609
Inventories	99,792	76,539
Property, plant and equipment	7,423	7,423
Tax losses carried forward	-	10
	1,334	1,275
Total	109,576	130,856

There were no expiry dates for the unrecognised deductible temporary differences except for a part of classified above as provisions of UAH 44,528 million as of 31 December 2019 which expired in 2020.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020

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 “Mahistralny gasoprovody Ukrainy” 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 required 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:

<i>In millions of Ukrainian hryvnias</i>	2020
Total consideration receivable	89,707
Net assets associated with disposal group	(98,015)
Loss on disposal of subsidiary	(8,308)

Results from the sale of subsidiary were recognised through equity, as this transaction is considered as a transaction between entities under common control of the State. Revaluation reserve in amount of UAH 161,056 related to property, plant and equipment transferred was reclassified from revaluation reserve to retained earnings, that is also

reflected in the consolidated statement of changes in equity. The change in the fair value relates to the remeasurement of the expected cash flows and presented in the consolidated statement of profit and loss as selling, general and administrative expenses.

The major group of assets and liabilities comprising the operations classified as held for sale and distribution are as follows:

<i>In millions of Ukrainian hryvnias</i>	31 December 2020	31 December 2019
Property, plant and equipment	-	108,421
Other non-current assets	-	177
Inventories	-	5,392
Trade accounts receivable	-	434
Prepayments made and other current assets	-	492
Prepaid corporate income tax	-	12
Cash and bank balances	-	423
Provisions	-	(270)
Deferred tax liabilities	-	(16,554)
Trade accounts payable	-	(54)
Advances received and other current liabilities	-	(458)
Net assets directly associated with disposal group	-	98,015

The results of the discontinued operations, which have been included in the profit for the year, were as follows:

<i>In millions of Ukrainian hryvnias</i>	2020	2019
Revenue	-	70,071
Income recognised per results of Gas Transit Arbitration	-	67,958
Interest and other income	-	1,876
Expenses	-	(62,545)
Profit before income tax	-	77,360
Attributable income tax expense	-	(16,647)
Profit for the year from discontinued operations	-	60,713
Profit for the year from discontinued operations (attributable to owners of the Company)	-	60,713

Cash flows from discontinued operations:

<i>In millions of Ukrainian hryvnias</i>	2020	2019
Cash flows from discontinued operations		
Net cash inflows from operating activities	-	101,690
Net cash outflows from investing activities	-	(333)
Net cash outflows from financing activities	-	(2,275)
Net cash inflows	-	99,082

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 limit 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-IX 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.

Ukraine’s 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 tax payers. 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 report 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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020

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 risk of outflow 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 “Karpatygas” 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 “Karpatygas” 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 participants' shares in the joint property.

In November 2020, the Stockholm Chamber of Commerce has rendered a Final Award by consent. The Final Award records a Settlement Agreement on settlement of legal relations between the Parties. According to the Settlement Agreement, the ownership of shares of Misen Enterprises AB and “Karpatygas” LLC in the joint operations shall pass to the Group from the date of full payment by the Group to Misen Enterprises and “Karpatygas” LLC in amount of UAH 1,337 million. The Group has paid the amount in full in February 2021.

Dispute with the non-controlling shareholders of “Ukrnafta” PJSC in respect of the validity and subsistence of shareholders agreement.

In January 2010, Naftogaz and the non-controlling shareholders of “Ukrnafta” PJSC (“Ukrnafta”) signed a shareholders agreement that included, among other, setting the procedure of electing the Chairman of the Board, appointment of the Executive Board and the Supervisory board members. Under the shareholders agreement (until the agreement was amended in April 2019) the Chairman of the Board was to be elected from among the candidates nominated by the non-controlling shareholders, 6 of 11 Ukrnafta Supervisory board members, including Chairman, were to be nominated by Naftogaz, and remaining 5 members by the non-

controlling shareholders.

Under the shareholders agreement, any dispute arising in connection with it is to be resolved exclusively by the London Court of International Arbitration and the shareholder agreement is governed by the English law.

In April 2018, Tribunal rendered the Partial Final Award by which it (i) acknowledged its jurisdiction over the claims, and declared that (ii) specific provisions of the shareholders agreement are unenforceable as a matter of English law by reason of their conflict with mandatory provisions of Ukrainian corporate law, but (iii) any such non-enforceability does not affect the enforceability of the shareholders agreement as a whole.

In order to bring the terms of the shareholders agreement in conformity with the Law of Ukraine “On Joint Stock Companies” Naftogaz, non-controlling shareholders of Ukrnafta and Ukrnafta concluded the additional agreement to the shareholders agreement in April 2019, which amended Article 9 of the shareholders agreement. In particular, the parties agreed that the Supervisory Board of “Ukrnafta” PJSC consists of 11 members elected by cumulative voting at the general meeting of shareholders; and includes at least 6 independent directors as requires by the Law of Ukraine “On Joint Stock Companies”; the chairman of the Supervisory Board is elected by the Supervisory 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 “Prydniprovskiy Long-Distance Pipeline” JSC (that were subsequently contributed to “Ukrtransnafta” JSC share capital), “Ukrspetstransgaz” SE, “Chornomornaftogaz” SE, “Ukrnafta” OJSC, 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 had the mechanism for calculating the state share in profits from using the assets been 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

obligations of the Company to operate state-owned gas transmission infrastructure were terminated. On 1 January 2020, the Ministry of Finance of Ukraine transferred state-owned assets related to the gas transmission system to the new transmission system operator under the long-term economic management agreement.

Capital commitments.

Capital commitments for purchase of property, plant and equipment, and exploration and development of oil and gas fields comprise UAH 3,868 million as at 31 December 2020 (31 December 2019: UAH 6,670 million).

risk management policy the Group identifies, assessed and develops actions to minimise the potential adverse effects on the Group’s financial performance for those risks

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

Major categories of financial instruments were as follows:

Financial assets at amortised cost:			
	Note	31 December 2020	31 December 2019
<i>In millions of Ukrainian hryvnias</i>			
Other non-current assets	7	2,078	4,317
Trade accounts receivable	9	28,129	59,056
Other current financial assets	10	1,879	1,705
Cash and bank balances		37,106	77,593
Restricted cash		659	436
Total financial assets at amortised cost		69,851	143,107

Financial assets at fair value:			
	Note	31 December 2020	31 December 2019
<i>In millions of Ukrainian hryvnias</i>			
Consideration receivable under the SPA	20	81,058	-
State treasury bonds of Ukraine	10	11,483	-
Total financial assets at fair value		92,541	-

Financial liabilities at amortised cost:			
	Note	31 December 2020	31 December 2019
<i>In millions of Ukrainian hryvnias</i>			
Borrowings	12	(66,342)	(60,662)
Trade accounts payable		(3,585)	(5,061)
Advances received and other current liabilities	14	(4,130)	(3,394)
Other long-term liabilities		(3,352)	(2,685)
Total financial liabilities		(77,409)	(71,802)

Market risk.

The Group is exposed to market risks. Market risks arise from open positions in (a) foreign currencies, (b) interest bearing

assets and liabilities, and (c) assets and liabilities that are exposed to other price risk.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020

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:

<i>In millions of Ukrainian hryvnias</i>	31 December 2020			31 December 2019		
	USD	EUR	Others	USD	EUR	Others
Restricted cash	584	50	-	235	45	-
Cash and bank balances	21,770	7,687	28	58,152	4,042	44
Trade accounts receivable	967	243	-	6,063	-	-
Prepayments made and other current assets	8,501	-	-	456	316	-
Other non-current assets	-	-	-	1,412	1	-
Borrowings	(32,640)	(24,405)	-	(24,605)	(16,982)	-
Trade accounts payable	(640)	(52)	-	(570)	(338)	(7)
Advances received and other current liabilities	(370)	(181)	-	(897)	(125)	-
Other long-term liabilities	(3,235)	-	-	(2,582)	-	-
Net (short)/long currency position	(5,063)	(16,658)	28	37,664	(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.

denominated in currencies other than the functional currency of the Group’s entities.

The exposure was calculated only for monetary balances

<i>In millions of Ukrainian hryvnias</i>	31 December 2020		31 December 2019	
	Impact on profit or loss before income tax	Impact on equity net income	Impact on profit or loss before income tax	Impact on equity net income tax
USD strengthening by 10%	(506)	(415)	3,767	3,089
USD weakening by 10%	506	415	(3,767)	(3,089)
EUR strengthening by 10%	(1,666)	(1,366)	(1,304)	(1,069)
EUR weakening by 10%	1,666	1,366	1,304	1,069

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 rate. 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 borrowings were provided at floating rates (31 December 2019: 1%). The risk of increase in market interest rates is monitored by the Treasury department of the Company. The key objective of managing interest rate risk is to get financing at a minimum costs, and match the liquidity needs with the proceeds from borrowings.

The borrowing activities are reviewed on an annual basis. Long-term investing activities and associated funding are considered separately, and are subject to the Government of Ukraine approval. The maturity dates of financial liabilities are further disclosed in this Note.

Other price 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 introduce 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 into 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:

<i>In millions of Ukrainian hryvnias</i>	31 December 2020		31 December 2019	
	Cash and bank balances	Restricted cash	Cash and bank balances	Restricted cash
A rating	58	-	45	-
B+ rating	1	-	37	-
B rating	36,421	645	77,173	228
B- rating	37	-	3	-
No rating	589	14	335	208
Total	37,106	659	77,593	436

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.

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The maturity analysis of financial liabilities as at 31 December 2020 was as follows:

<i>In millions of Ukrainian hryvnias</i>	Up to 6 months	6-12 months	1-2 years	2-5 years	Over 5 years	Total
Borrowings	7,147	6,478	17,653	37,282	15,295	83,855
Trade accounts payable	3,585	-	-	-	-	3,585
Advances received and other current liabilities	4,130	-	-	-	-	4,130
Other long-term liabilities	-	-	871	3,035	-	3,906
Total	14,862	6,478	18,524	40,317	15,295	95,476

The maturity analysis of financial liabilities as at 31 December 2019 was as follows:

<i>In millions of Ukrainian hryvnias</i>	Up to 6 months	6-12 months	1-2 years	2-5 years	Over 5 years	Total
Borrowings	9,501	8,265	7,015	42,608	13,808	81,197
Trade accounts payable	5,061	-	-	-	-	5,061
Advances received and other current liabilities	3,394	-	-	-	-	3,394
Other long-term liabilities	-	-	1,060	2,194	-	3,254
Total	17,956	8,265	8,075	44,802	13,808	92,906

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.

The gearing ratio at the end of the reporting period was as following:

<i>In millions of Ukrainian hryvnias</i>	31 December 2020	31 December 2019
Total borrowings (Note 12)	66,342	60,662
Less: cash and cash equivalents	(37,106)	(77,593)
Adjusted for cash received from Gazprom and interim dividends paid	-	59,494
Total Net Debt	29,236	42,563
Total Equity	314,281	392,574
Gearing ratio, %	8.5	9.8

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):

Assets	Fair value hierarchy	Valuation techniques and key inputs
Property, plant and equipment	3	<p>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.</p> <p>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.</p> <p>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.</p>
	2	<p>For the items for which there are market analogs (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.</p>

The following table summarises property, plant and equipment recognised at fair value after initial recognition using a fair value hierarchy:

	31 December 2020			31 December 2019		
<i>In millions of Ukrainian hryvnias</i>	Level 2	Level 3	Total	Level 2	Level 3	Total
Property, plant and equipment	4,219	179,839	184,058	4,283	201,264	205,547
Total	4,219	179,839	184,058	4,283	201,264	205,547

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.

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Details of the Group’s property, plant and equipment and information about the fair value hierarchy as at 31 December 2020 are as follows:

Description	Group of assets	Valuation technique	Unobservable inputs	Range of unobservable inputs	Interrelationship between key unobservable inputs and fair value measurement
Gas storages	Underground gas storages equipment	Depreciated replacement cost method using the income approach for economic obsolescence determination	Nominal WACC for USD-denominated cash flows	14.35%	The higher the weighted average cost of capital, the lower the fair value
	Cushion gas		Estimated average period of cushion gas withdrawal	5 years starting from 2025	The longer the period, the lower the fair value
Gas extraction assets	Gas and oil upstream	Depreciated replacement cost method using the income approach for economic obsolescence determination	Natural gas selling price	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.	The higher the selling price, the higher the fair value
			Long-term forecast of royalty rates (estimated for selling price)	Natural gas and crude oil deposits at depths up to 5000 m – 29%, over 5000 m – 14% Oil and gas condensate deposits at depths up to 5000 m – 31%, over 5000 m – 16%	The higher the rate, the lower the fair value
			Nominal weighted average cost of capital for UAH denominated cash flows	15.96%-17.93%	The higher the weighted average cost of capital, the lower the fair value
			Proved developed reserves as assessed by the independent appraiser	1 – 47.681 mcm (remaining gas reserves depending on the field)	The higher the volume, the higher the fair value
Oil transmission system and storages	Oil transmission system	Depreciated replacement cost method using the income approach for economic obsolescence determination	Cumulative factor of physical and functional depreciations	0.28-0.80	The higher the factor, the lower the fair value
			Transit volumes	12.0-13.4 million tons	The higher the volumes, the higher the fair value
			Applicable tariffs	8.6-11.6 euro per ton	The higher the tariff, the higher the fair value
			Nominal WACC for UAH-denominated cash flows	12.54%	The higher the weighted average cost of capital, the lower the fair value
			Nominal WACC for UAH-denominated cash flows	13.24%	The higher the weighted average cost of capital, the lower the fair value

Details of the Group’s property, plant and equipment and information about the fair value hierarchy as at 31 December 2019 are as follows:

Description	Group of assets	Valuation technique	Unobservable inputs	Range of unobservable inputs	Interrelationship between key unobservable inputs and fair value measurement
Gas storages	Underground gas storages equipment	Depreciated replacement cost method using the income approach for economic obsolescence determination	The rate of return on the regulatory basis of assets for storage	14.52%	The higher the rate, the higher the fair value
	Cushion gas		Nominal WACC for USD-denominated cash flows	12.57%	The higher the weighted average cost of capital, the lower the fair value
			Estimated average period of cushion gas withdrawal	5 years	The longer the period, the lower the fair value
Gas extraction assets	Gas and oil upstream	Depreciated replacement cost method using the income approach for economic obsolescence determination	Natural gas selling price	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.	The higher the selling price, the higher the fair value
			Long-term forecast of royalty rates (estimated for selling price)	Natural gas and crude oil deposits at depths up to 5000 m – 29%, over 5000 m – 14% Oil and gas condensate deposits at depths up to 5000 m – 31%, over 5000 m – 16%	The higher the rate, the lower the fair value
			Nominal weighted average cost of capital for UAH denominated cash flows	18.58%-20.05%	The higher the weighted average cost of capital, the lower the fair value
			Proved developed reserves as assessed by the independent appraiser	1 – 47.681 mcm (remaining gas reserves depending on the field)	The higher the volume, the higher the fair value
Oil transmission system and storages	Oil transmission system	Depreciated replacement cost method using the income approach for economic obsolescence determination	Cumulative factor of physical and functional depreciations	0.42-0.85	The higher the factor, the lower the fair value
			Nominal WACC for UAH-denominated cash flows	13.24%	The higher the weighted average cost of capital, the lower the fair value

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Fair value of financial assets and financial liabilities that are not measured at fair value on a recurring basis (but fair value disclosures are required)

assets and liabilities do not differ significantly from their fair values as at 31 December 2020 and 2019, except as disclosed below:

Management believes that carrying amounts of financial	31 December 2020		31 December 2019	
	Carrying value	Fair value	Carrying value	Fair value
<i>In million of Ukrainian hryvnias</i>				
Eurobonds (Note 12)	44,383	48,456	35,538	38,930

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):

Financial liabilities	Fair value hierarchy	Valuation techniques and key inputs
Eurobonds	1	Fair value of Eurobonds is measured at quoted prices in active markets using interest rates of 5.0%-6.8% p.a.

Fair value of consideration receivable under the SPA

As described in Note 20, on 1 January 2020 100% of the participatory rights of “Gas Transmission System Operator of Ukraine” LLC were transferred to “Mahistralny gasoprovody Ukrainy” JSC under the SPA and on terms of initial payment and regular payments for 15 years and establishment of a dynamic price calculated in accordance with the formula agreed by the parties. The fair value of variable consideration was recognised as a financial asset at fair value though profit or loss (FVTPL).

Fair value of State treasury bonds

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 tables provides information about how the fair value of variable consideration is determined (in particular, the valuation techniques and inputs used:

Assets	Fair value hierarchy	Valuation techniques and key inputs
Consideration receivable	3	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 11.74%

Inputs used for determination of variable consideration fair value were as follows:

Valuation technique	Unobservable inputs	Range of unobservable inputs	Interrelationship between key unobservable inputs and fair value measurement
Discounted cash flow model	Period when transit revenues are received	2020-2034	The longer the period of income generation from transit, the higher the fair value
	Applicable transit volumes	65 bcm p.a in 2020 and 40 bcm p.a in the next four years (based on a Transportation Organisation Agreement between Naftogaz and Gazprom). From 2024 – 40 bcm p.a (based on management expectations).	The higher the volumes, the higher the fair value
	Regulated Asset Base tariffs	The RBA-based (Regulatory Asset Base) 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 stimulating tariff regulation methodology parameters.	The lower the RBA, the lower the fair value
	Nominal WACC for USD-denominated cash flows	11.74%	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 3,749 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 Yuzivka site located in Donetsk and Kharkiv region and has special permits until 2063. The cost of investments amounted to UAH 432 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. Items included in 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 hryvnias (“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:

<i>In Ukrainian hryvnias</i>	2020	2019
USD 1.00	28.27	23.69
EUR 1.00	34.74	26.42

The average exchange rates for the year ended 31 December were:

<i>In Ukrainian hryvnias</i>	2020	2019
USD 1.00	26.96	25.85
EUR 1.00	30.79	28.95

During 2020 and 2019 in Ukraine there were certain restriction 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 Company 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 or not the Group’s voting rights in an investee are sufficient to give it power, including:

- the size of the Group’s holding of voting rights relative to the size and dispersion of holdings of the other vote holders;
- potential voting rights held by the Group, other vote holders or other parties;
- rights arising from other contractual arrangements; and
- any additional facts and circumstances that indicate that the Group has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, 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.

At the acquisition date, the identifiable assets acquired and the liabilities assumed are recognised at their fair value, except that:

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- deferred tax assets or liabilities, and assets or liabilities related to employee benefit arrangements are recognised and measured in accordance with IAS 12 “Income Taxes” and IAS 19 “Employee Benefits” respectively;
- liabilities or equity instruments related to share-based payment arrangements of the acquiree or 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 “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 acquirer'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 acquirer'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 entity's net assets in the event of liquidation may be initially measured either at fair value or at the non-controlling interests' proportionate share of the recognised amounts of the acquiree's identifiable net 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 specified in another IFRS.

When the consideration transferred by the Group in a business combination includes assets or liabilities resulting from a contingent consideration arrangement, the contingent consideration is measured at its acquisition-date fair value and included as part of the consideration transferred in a business combination. Changes in the fair value of the contingent consideration that qualify 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 equity is not remeasured at subsequent reporting dates and its subsequent settlement is accounted for within equity. Contingent consideration that is classified as an asset or a liability is remeasured at subsequent reporting dates in accordance with IFRS 9 “Financial Instruments”, or IAS 37 “Provisions, Contingent Liabilities and Contingent Assets”, as appropriate, with the corresponding gain or loss being recognised in profit or loss.

When a business combination is achieved in stages, the Group's previously held equity interest in the acquiree is remeasured to its acquisition-date fair value and 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 have previously been recognised in other 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, the Group reports provisional amounts for the items for 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. 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, the impairment loss is allocated 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 the carrying amount of each asset 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 acquired of the 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. 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. This may mean that 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 retained, only a proportionate share of the amounts previously recognised in other comprehensive

income are reclassified to profit or loss where appropriate.

Investments in associates. Associates are entities over which the Group has significant influence but not control. Investments in associates are accounted for using the equity method of accounting. The Group's investment in associate includes goodwill identified on acquisition, net of any accumulated impairment loss.

The Group's share of its associates' post-acquisition profits or losses is recognised in the consolidated statement of profit or loss, and its share of post-acquisition movements in other comprehensive income is recognised in other comprehensive income. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate. Unrealised gains on transactions between the Group and its associates are eliminated.

Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

Dilution of gains and losses arising on investments in associates are recognised in the consolidated statement of profit or loss.

Interest in joint ventures. A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the joint arrangement. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require unanimous consent of the parties sharing control.

The Group recognises its interest in the joint venture using the equity method applied as described above in the paragraph **Investments in associates**.

Interests in joint operations. A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require unanimous consent of the parties sharing control.

When a group entity undertakes its activities under joint operations, the Group as a joint operator recognises in relation to its interest in a joint operation:

- Its assets, including its share of any assets held jointly;
- Its liabilities, including its share of any liabilities incurred jointly;
- Its share of the revenue from the sale of the output by the joint operation; and
- Its expenses, including its share of any expenses incurred jointly.

The Group accounts for the assets, liabilities, revenues and expenses relating to its interest in a joint operation in accordance with the IFRS applicable to the particular assets, liabilities, revenues and expenses.

When a group entity transacts with a joint operation in which a group entity is a joint operator (such as a sale or contribution of assets), the Group is considered to be conducting the transaction with the other parties to the joint operation, and gains and losses resulting from the transactions

are recognised in the Group's consolidated financial statements only to the extent of other parties' interests in the joint operation.

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 does not recognise its share of the gains and losses until it resells those assets to a third party.

Concession agreement (product sharing agreement).

The Company entered into a concession agreement for oil exploration and development (“Concession Agreement”) with the Arab Republic of Egypt and the Egyptian General Petroleum Corporation (“EGPC”) on 13 December 2006.

The Concession Agreement includes the following conditions:

- Subject to the auditing provisions under the Concession Agreement, the Company shall recover on a quarterly basis all exploration and development costs to the extent and out of 25% of all petroleum produced and saved from all production areas and not used in petroleum operations (“Cost Recovery”). Petroleum products under the Concession Agreement include crude oil or gas and liquefied petroleum gas (“LPG”).
 - Remaining 75% of the petroleum produced is shared by the Company and EGPC depending on the volume of production and the product type (crude oil or gas and LPG). The Company's share varies from 15% to 19%.
 - EGPC shall become the owner of all the Company's assets acquired and owned within the Concession Agreement, which were charged to Cost Recovery by the Company in connection with the operations carried out by the Company: land shall become the property of EGPC as soon as it is purchased; title to fixed and movable assets shall be transferred automatically and gradually from the Company to EGPC as they become subject to the Cost Recovery.
- The development period under the Concession Agreement is limited to maximum 25 years from the date of commercial oil discovery or from the date of first gas deliveries, started in 2010.

Segment reporting. Operating segments are reported in a manner consistent with the internal reporting provided to the Group's chief operating decision maker. Segments whose revenue, results or assets are ten percent or more of all the segments are reported separately. Segments falling below this threshold can be reported separately at management decision.

Property, plant and equipment. The Group uses the revaluation model to measure property, plant and equipment, except for other fixed assets and construction in progress which is carried at cost. Fair value was based on valuations made by external independent appraisers. The frequency of revaluation depends on the movements in the fair values of the assets being revalued. The last independent valuation of the fair value of the Group's major groups of property, plant and equipment was performed as at 1 October 2019 and as at 1 December 2020 for “Oil transmission system”. Subsequent additions to property, plant and equipment are recorded at cost. Cost includes expenditure directly attributable to acquisition of the items. The cost of self-constructed assets includes the cost of materials, direct labour and an appropriate proportion of production overheads. Cost of acquired and self-constructed qualifying assets includes borrowing costs.

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Any increase in the carrying amounts resulting from revaluations are credited to revaluation 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 the same revalued 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, the amounts included in revaluation reserve are transferred to retained earnings.

Property, plant and equipment includes cushion gas which is required to be held in the storage facilities for the operating activities of the Group's subsidiary in gas storage segment. 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 up it from the storage. When gas is sold, the Company will have to cover costs to liquidate wells and other infrastructure. Cushion gas is revalued when there is an indication that its carrying amount as 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 in the period in which they are incurred. Development costs are capitalised if the recognition criteria according to IAS

38 "Intangible Assets" are fulfilled.

Exploration and evaluation assets. Oil and gas exploration and evaluation expenditures are accounted for using the successful efforts method of accounting.

Expenditures at the exploration stage of hydrocarbon reserves' exploration and evaluation, including the economic and technical feasibility studies for exploratory field development and advisory services, are recognised as expenses of the period when incurred.

Expenses directly related to obtaining special rights to extraction of mineral resources reserves are capitalised in cost of licenses for exploration and recognised as intangible assets from the date of special rights. Subsequently, the relevant assets are accounted for using the requirements of IAS 38 "Intangible Assets".

Expenses arising at the stage of field development, including costs of drilling and trenching, leases and depreciation of property, plant, and equipment, are capitalised in construction in progress as exploration and evaluation assets. The assets created are reviewed for impairment on an annual basis. In case the exploratory drilling does not give a result or it is probable that the expenses incurred will not generate revenue, the asset is partially or fully written off against expenses of the period.

In the event a decision is taken on further development of the field and from the date of putting into operation of the first producing well, the Group classifies the capitalised exploration and evaluation costs related to this well as oil and gas extraction assets within property, plant, and equipment in the consolidated statement of financial position.

Depreciation and depletion. Depreciation is charged to the consolidated statement of profit or loss on a straight-line basis to allocate costs of individual assets except their residual value over their estimated useful lives. Depreciation commences on the date of acquisition or, in respect of self-constructed assets, from the time an asset is completed and ready for use.

Hydrocarbon extraction wells are depleted using a unit-of-production method over the life of proved developed hydrocarbons reserves. Specialised drilling tools and other fixed assets used to perform any work on the well are depleted using a unit-of-production method based on relevant output standard established by the Group.

Other property, plant and equipment are depreciated on a straight line basis over its expected useful life. The useful lives of the Group's other property, plant and equipment are as follows:

	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 refinery	2-60
Filling stations	2-60
Gas distribution assets	2-60
LNG transportation	2-60
Other fixed assets	3-30

Construction in progress and cushion gas are not depreciated.

Intangible assets. Intangible assets have definite useful lives and primarily include licenses for exploration and extraction and capitalised computer software. Acquired computer software is 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 impaired, the carrying amount of intangible assets 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 costs of individual assets over their estimated useful lives.

Leases. According to IFRS 16, the Group records assets in the form of the right-of-use and lease liability 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 rate implicit in 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 are 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 of low value assets (such as personal laptops and office furniture), the Group records lease payments as an operating expense on a straight line basis over the term of the lease in accordance with the requirements of IFRS 16.

Leases in lessor accounting in which a significant portion of the risks and rewards of ownership are retained by the lessor are 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 provision. Estimated costs of dismantling and removing an item of property, plant and equipment are added to the cost of an item of property, plant and equipment when the item is acquired, and corresponding obligation is recognised. Changes in the measurement of an existing decommissioning liability, that result from changes in the estimated timing or amount of the outflows, or from changes in the discount rate used for measurement, are recognised in the consolidated statement of profit or loss or, to the extent of any revaluation balance existence 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 finance 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 cost to sell and value in use. For purposes of assessing impairment, assets are grouped to the lowest levels for which there are separately

identifiable cash flows (cash generating unit). Non-financial assets that have incurred impairment are reviewed for possible reversal of the impairment at each reporting date.

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 (or a cash-generating unit) 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 determined 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 measured at fair value.

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 a financial instrument. All other purchases and sales are recognised on the settlement date.

Classification and subsequent measurement of financial assets. Financial assets are subsequently measured at amortised cost or fair value. Specifically, debt investments that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortised cost at the end of subsequent accounting periods. Debt instruments that are held within a business model whose objective is achieved both by collecting contractual cash flows and selling financial assets, and that have contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding, are generally measured at fair value through other comprehensive income. All other debt investments and equity investments are measured at their fair value through profit or loss at the end of subsequent accounting periods.

Amortised cost is calculated using the effective interest method and, for financial assets, it is determined net of any impairment losses. Premiums and discounts, including initial transaction costs, are included in the carrying amount of the related instrument and amortised based on the effective interest rate of the instrument.

The Group uses practical expedient according to which the amortised cost of financial assets with a maturity of less than one year, less any estimated credit losses, are assumed to be their face values.

Equity instruments. An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.

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Dividends on equity instruments are recognised in the consolidated statement of profit or loss when the Group's right to receive payment is established and the inflow of economic benefits is probable. Impairment losses are recognised in the consolidated statement of profit or loss when incurred as a result of one or more events that occurred after the initial recognition of equity investments. A significant or prolonged decline in the fair value of such instrument below its cost is an indicator that it is impaired. The cumulative impairment loss measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that asset previously recognised in the consolidated statement of profit or 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 lifetime expected credit losses for its 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 overdue for more than 365 days, for counterparty receivables that entered bankruptcy, liquidation or financial reorganisation, and counterparty receivables that are located on temporarily occupied territories of Ukraine. 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 provision for financial 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 liabilities. Financial liabilities are subsequently measured at amortised cost or fair value through profit or loss ("FVTPL").

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) through the expected life of the financial liability, or (where appropriate) a shorter period, to the amortised cost of a financial liability.

Derecognition of financial instruments. The Group derecognises financial assets when (i) the assets are redeemed or the rights to cash flows from the assets have otherwise expired or (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 does not have the practical 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 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 financial statements in accordance with Ukrainian legislation enacted or substantively enacted by the end of 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 to or recovered from the taxation authorities in respect of taxable profits or losses for the current and prior periods. Taxes other than on income are recorded within operating expenses.

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 recorded, affects neither accounting nor taxable profit. Deferred tax liabilities are not recorded for temporary differences on initial recognition of goodwill and subsequently for goodwill which is not deductible for tax purposes. Deferred tax balances are measured at tax rates enacted or substantively enacted at the reporting date which are expected to apply to the period when the temporary differences will reverse or the tax losses carried forwards will be utilised. Deferred tax assets and liabilities are netted only within the individual companies of the Group. Deferred tax assets for deductible temporary differences and tax losses carried forwards are recorded only to the extent that it is probable that future taxable profit will be available against which the deductions can be utilised.

Inventories. Inventories are recorded at the lower of cost and net realisable value. The cost of inventories includes expenditures incurred in acquiring the inventories, production or conversion costs and other costs incurred in bringing them to their existing location and condition. Cost of manufactured inventories includes an appropriate share of production overheads based on normal operating capacity. The cost of inventories is determined on the first in first out basis for all inventories except for natural gas, oil and petroleum products. Weighted average cost formula is used for natural gas, oil and petroleum products. Net realisable value is the estimated selling price in the ordinary course of business, less the cost of completion and selling expenses.

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.

Prepayments made and other current assets.

Prepayments are carried at cost excluding VAT less provision for impairment. A prepayment is classified as non-current 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 received, the Group recognises provision for impairment in respect of such prepayment made and a corresponding impairment loss is recognised in the consolidated statement of profit or loss.

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 balances are excluded from cash and cash equivalents for the purposes of the consolidated statement of cash flows. Balances restricted from being exchanged or used to settle a liability for the period from three to twelve months after the reporting date are included in other current assets. Balances restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date are included in other non-current asset.

Share capital. Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds.

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 proposed 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 0% 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 a 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 a taxpayer is entitled to offset against his VAT 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 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 impairment of receivables, the impairment loss is recorded for the gross amount of the debtor, including VAT, except provision for impairment of prepayments made.

Borrowings. Borrowings include bank borrowings and bonds.

Borrowing costs. Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets 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 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 method. Amortised cost is calculated by taking into account any transaction costs and any discount or premium on settlement.

Advances received. Advances received are carried at amounts originally received excluding VAT. Amounts of advances received are expected to be realised through the revenue received from usual activities of the Group.

Provisions. Provisions are recognised when the Group has a present obligation (legal or constructive) 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 and a reliable estimate can be made of the amount of the obligation.

Where the Group expects some or all of a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

The expense on any provision is presented in the consolidated statement of profit or loss net of any reimbursement. If the effect of time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in provision due to the passage of time is recognised as a finance cost.

Other liabilities. Other financial liabilities are recognised initially at fair value, net of transaction costs incurred, and are subsequently stated at amortised cost using the effective interest method. Other non-financial liabilities are measured at cost.

Contingent assets and liabilities. A contingent asset is not recognised in the consolidated financial statements but disclosed when an inflow of economic benefits is probable.

A contingent liability is not recognised in the consolidated financial statements unless it is probable that an outflow of economic resources will be required to settle the obligation and it can be reasonably estimated. Contingent liabilities are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote.

Revenue recognition. The Group recognises revenue when

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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 specific 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 lapsed, 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 in.

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” LLC. 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 provide the specified service;
- it bears the risk of price change for transmission services through the territory of Ukraine.

Recognition of expenses. Expenses are recorded on an accrual basis. Costs incurred in process of production, storage, distribution and transportation of hydrocarbons are classified as Production and Manufacturing Expenses. Purchases 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 as the government assistance and accounts for it as government grant related to income.

The Company recognised the government assistance when there was reasonable assurance that the assistance will be received, and all attached conditions will be complied with, as permitted by IAS 20.

The Company presents the compensation for performing public service obligations as a separate line on the face of the consolidated profit or loss statement.

Finance income and costs. Finance income and costs comprise interest expense on borrowings, losses on early repayment of loans, interest income on deposits and current accounts, income or loss on origination of financial instruments, unwinding of interest of the pension obligation and provisions.

Interest income is recognised as it accrues, taking into account the effective yield on the asset.

Employee benefits: Defined Contributions Plan. The Group makes statutory unified social contributions to the Pension Fund of Ukraine in respect of its employees. The contributions

are calculated as a percentage of current gross salary and are expensed when incurred. Discretionary pensions and other post-employment benefits are included in labour costs in the consolidated statement of profit or loss.

During the year ended 31 December 2020, the Group recognised expenses from contributions paid to the Pension Fund of Ukraine in amount of UAH 2,281 million (2019: UAH 2,758 million).

Employee benefits: Defined Benefit Plan. The Group provides lump sum benefits, payments on reaching certain age, and other benefits as prescribed by the collective agreement. The liability recognised in the consolidated statement of financial position in respect of the defined benefit pension plan is the present value of the defined benefit obligation at the reporting date. The defined benefit obligation is calculated annually using the projected unit credit method.

Present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating the terms of the related pension liability.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to other comprehensive income in the period in which they arise. Past service costs are recognised immediately in the consolidated statement of profit or loss.

Consolidated Statement of Profit and Loss presentation. In 2020, the Group changed its presentation of the consolidated statement of profit and loss for the year ended 31 December 2019. The reason for such change was to better reflect the nature of the expense, increase comparability and align the Group’s presentation with other leading companies within the Group’s industry:

- Three new line items were introduced: (i) Purchases, (ii) Production and manufacturing expenses, and (iii) Selling, general and administrative expenses;
- Line items “Cost of sales” and “Other operating expenses” are retired;
- Line items “Depreciation, depletion and amortization”, “Impairment losses” and “Net movement in provision for financial assets” were presented separately on the face of the consolidated statement of profit and loss.

The effect of the retrospective change in presentation and the discontinued operations on the consolidated statement of profit or loss for the year ended 31 December 2019 was as follows:

	2019, as previously reported including discontinued	Effect of change in presentation	Reclassified as discontinued operations	2019, as restated
<i>In millions of Ukrainian hryvnias</i>				
Cost of sales	(152,076)	152,076	-	-
Other operating expenses	(54,215)	54,215	-	-
Other operating income	72,816	(72,816)	-	-
Finance income	1,915	(1,915)	-	-
Interest and other income	-	2,048	4	2,052
Research, development and exploration costs	-	(804)	-	(804)
Purchases	-	(41,589)	-	(41,589)
Production and manufacturing expenses	-	(77,890)	24,020	(53,870)
Selling, general and administrative expenses	-	52,255	(68,270)	(16,015)
Foreign exchange gain	1,414	-	523	1,937
Depreciation, depletion and amortisation	-	(34,439)	20,231	(14,208)
Impairment loss	-	(10,230)	806	(9,424)
Net movement in provision for financial assets	-	(21,670)	15,199	(6,471)
Finance costs	(7,334)	753	204	(6,377)

Consolidated Statement of Cash Flows presentation. Interest received was reclassified from Cash generated by operating activities to Cash flows from investing activities. The reason for such change was to better reflect the nature of cash flows. Such reclassification did not have the material impact on the consolidated statement of cash flows. These changes are effective from 1 January 2020. Comparative information for the year ended 31 December 2019 was restated respectively.

Additionally, some other comparative information presented in the consolidated financial statements for the year ended 31 December 2019 has been changed to aid comparability with the presentation of the consolidated financial statements for the year ended 31 December 2020. Such reclassifications did not have a material impact on these consolidated financial statements.

The Group has not early adopted any standard, interpretation or amendment that has been issued but is not yet effective.

26. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

In the application of the Group’s accounting policies, management is required to make judgements, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Critical judgements in applying accounting policies. The following are the critical judgements, apart from those involving estimations, that the Group management has made in the process of applying the Group’s accounting policies and that have the most significant effect on the amounts recognised in the consolidated financial statements. The critical judgements

are described in relevant sections of the Note 3 (related to PSO compensation) and Note 5 (related to revaluation of “Underground gas storages”).

Key sources of estimation uncertainty. The following are the key assumptions concerning the future, and other key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Impairment of financial assets. Management estimates the likelihood of the collection of trade and other accounts receivable based on an analysis of individual accounts. Factors taken into consideration include an aging analysis of trade and other receivables with reference to the payment history, credit terms allowed to customers, and available market information regarding the counterparty’s ability to pay. Should actual collections be less than management’s estimates, the Group would be required to record an additional impairment expense.

As at 31 December 2020, the Group accrued a provision for impairment of financial assets for gas of regional gas distribution entities in full amount, as expected credit losses for these entities are estimated at 100%, after all, the loss given default rate on these counterparties is estimated by the Company at 100%.

Employee benefit obligations. The Group assesses post-employment and other employee benefit obligations using the projected unit credit method based on actuarial assumptions which represent management’s best estimates of the variables that will determine the ultimate cost of providing post-employment and other employee benefits. The present value of the pension obligations depends on a number of factors that are determined on an actuarial basis using a number of assumptions. The major assumptions used in determining the net cost (income) for pensions include the discount rate and expected salary increases. Any changes in these assumptions will impact the carrying amount of pension obligations. Since there are no long-term, high quality corporate or government bonds issued in Ukrainian hryvnias, significant judgement is needed in assessing an appropriate discount rate. Key assumptions are presented in Note 13

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2020

there are no long-term, high quality corporate or government bonds issued in Ukrainian hryvnias, significant judgement is needed in assessing an appropriate discount rate. Key assumptions are presented in Note 13.

Decommissioning costs. The decommissioning provision represents the present value of the decommissioning costs relating to oil and gas properties, which are expected to be incurred in the future (Note 13). These provisions were recognised, based on Group’s internal estimates.

Main estimates include future market prices for the necessary decommissioning costs, and are based on market conditions and factors. Additional uncertainties 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 of such hydrocarbons at the beginning of the period. Changes in estimates regarding the volumes of total proved reserves either downward or upward, can result in the change of depreciation and depletion expenses.

Estimation of oil and gas reserves. Reserves are the quantities of oil and gas which are anticipated to be commercially recovered from known accumulations from a given date forward under defined conditions. Proved and probable reserves used in depletion rate calculation are determined using estimates of known oil and gas reservoirs, recovery factors, operating conditions, future oil and gas prices and government regulations. Latest assessment of gas reserves was performed as at 1 January 2020, and latest assessment of oil reserves was performed as at 1 April 2019. Reserves estimates involve some degree of uncertainty, and their estimates are revised as additional geologic and engineering data becomes available or as economic conditions change. Accordingly, depletion rates and discounted cash flows for revaluation and impairment of property, plant and equipment may be also revised.

Revaluation and impairment of property, plant and equipment. Management performs assessment whether carrying amounts of property, plant and equipment accounted under the revaluation model, differ materially from their fair values. Such assessment is performed on an annual basis, and involves analysis of prices, price indices, changes in technology, foreign exchange rates and other relevant factors. In case such assessment identifies that carrying amounts of items of property, plant and equipment differ materially from their fair values, management engages independent appraisers to perform property, plant and equipment revaluation.

The Group engaged independent appraisers to determine the fair value of its major groups of property, plant and equipment as at 1 October 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 impairment indicators for the certain groups of property, plant and equipment. The Group has engaged an independent appraiser for testing the existence of economic impairment of relevant groups of cash generating units and, accordingly, recorded the impairment of property, plant and equipment in a total amount of UAH 7,154 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 consensus 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 ability to utilise 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) and compares it to the carrying value, and records impairment to the extent the carrying value is greater than the recoverable amount.

Useful lives of other property, plant and equipment. The Group’s property, plant and equipment, except oil and gas assets are depreciated 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 are 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 current 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 the estimates may impact the amount of the allowances for inventory that may be required.

Assets held for sale and distribution. As described in Note 20, on 31 December 2019 the Group reclassified assets related to gas transmission activities as assets of discontinued operations classified as held for sale and distribution. Managemet considered the assets to meet the criteria to be classified as held for sale and distribution at that date following that sale and distribution of assets was highly probable and assets became available for sale and distribution in their current condition for the following reasons:

- all conditions, prescribed in the CMU Resolution “On Unbundling of Natural Gas Transmission Activity and Enabling Activity of Transmission System Operator” #840 dated 18 September 2019 to unbundle gas transmission activities on the 1 January 2020 were met;
- gas transit agreement between Naftogas and Gazprom, limiting the ability to unbundle gas transmission activities and transfer the respective assets, was terminated on 1 January 2020;
- on 24 December 2019 , “Gas Transmission System Operator of Ukraine” LLC was granted the license for natural gas transportation activities effective from 1 January 2020. For more details on the discontinued operations, refer to Note 20.

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 beginning on or after 1 January 2020;

- Amendments to References to the Conceptual Framework in IFRS Standards;
- 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 3 “Business Combinations”: Definition;
- Amendments Amendments to IFRS 9 “Financial Instruments”, IAS 39 “Financial Instruments: Recognition and Measurement” and IFRS 7 “Financial Instruments: Disclosure”: Interest Rate Reform.

The adoption of amendments to standards did not have any effect on the financial position or performance reported in the consolidated financial statements and had not resulted in any changes to the Company’s accounting policies and the amounts reported for the current or prior years.

Standards and Interpretations in issue, but not yet effective. At the date of authorisation of these consolidated financial statements, the following Standards and Interpretations, as well as amendments to Standards were in issue but not yet effective:

Standards/Interpretations	Effective for annual accounting period beginning on or after:
IFRS 4 “Insurance Contracts”: Amendments regarding replacement issues in the context of the IBOR reform	1 January 2021
IFRS 7 “Financial Instruments: Disclosures”: Amendments regarding replacement issues in the context of the IBOR reform	1 January 2021
IFRS 9 “Financial Instruments”: Amendments regarding replacement issues in the context of the IBOR reform	1 January 2021
IFRS 16 “Leases”: Amendments regarding replacement issues in the context of the IBOR reform	1 January 2021
IAS 39 “Financial Instruments: Recognition and Measurement”: Amendments regarding replacement issues in the context of the IBOR reform	1 January 2021
IFRS 1 “First-time Adoption of International Financial Reporting Standards”: Amendments resulting from Annual Improvements to IFRS Standards 2018–2020 (subsidiary as a first-time adopter)	1 January 2022
IFRS 3 “Business Combinations”: Amendments updating a reference to the Conceptual Framework	1 January 2022
IFRS 9 “Financial Instruments”: Amendments resulting from Annual Improvements to IFRS Standards 2018–2020 (fees in the ‘10 per cent’ test for derecognition of financial liabilities)	1 January 2022
IAS 16 “Property, Plant and Equipment”: Amendments prohibiting a company from deducting from the cost of property, plant and equipment amounts received from selling items produced while the company is preparing the asset for its intended use	1 January 2022
IAS 37 “Provisions, Contingent Liabilities and Contingent Assets”: Amendments regarding the costs to include when assessing whether a contract is onerous	1 January 2022
IFRS 17 “Insurance contracts”	1 January 2023
IFRS 4 “Insurance Contracts”: Amendments regarding the expiry date of the deferral approach	1 January 2023
IAS 8 “Accounting Policies, Changes in Accounting Estimates and Errors”: Amendments regarding the definition of accounting estimates	1 January 2023
Amendments to IAS 1 “Presentation of Financial Statements”: Amendments regarding the classification of liabilities, Amendments regarding the disclosure of accounting policies	1 January 2023
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 discloses 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, forms of communication between them and ways to provide them with information.

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

Aspect	Topic	Scope of the topic
Economic	Economic efficiency	All Naftogaz Group companies
	Indirect economic impact	Ukrasvydobuvannya, Ukrnafta, Ukrtransgaz, Ukrtransnafta
	Procurement practices	All Naftogaz Group companies
Environmental	Energy	Ukrasvydobuvannya, Ukrnafta, Ukrtransgaz, Ukrtransnafta
	Water	Ukrasvydobuvannya, Ukrnafta, Ukrtransgaz, Ukrtransnafta, Ukrspetstransgaz, Ukravtogaz, Naftogaz Teplo, Kirovogradgaz, Naftogaz of Ukraine NJSC (apparatus)
	Biodiversity	All Naftogaz Group companies
	Emissions	All Naftogaz Group companies
	Waste	Ukrasvydobuvannya, Ukrnafta, Ukrtransgaz, Ukrtransnafta, Ukrspetstransgaz, Ukravtogaz, Kirovogradgaz, Chornomornaftogaz, Naukanaftogaz, Naftogaz Teplo, Naftogaz of Ukraine NJSC (apparatus)
	Compliance with environmental requirements	All Naftogaz Group companies
Social	Employment	All Naftogaz Group companies
	Relationship between employees and management	All Naftogaz Group companies
	Health and safety at work	All Naftogaz Group companies
	Training and education	All Naftogaz Group companies
	Diversity and equal opportunities	All Naftogaz Group companies
	Anti-discrimination	All Naftogaz Group companies
	Child labor	All Naftogaz Group companies
	Forced and compulsory labor	All Naftogaz Group companies
	Support for local communities	All Naftogaz Group companies

GRI Index

Material topic	Disclosure number	Disclosure title	Page number	References and comments
GRI 102: General standards				
GRI 102: General Disclosures 2016. Organizational profile	102-1	Name of the organization	-	NJSC “Naftogaz of Ukraine” (Naftogaz Group)
	102-2	Activities, brands, products, and services	58	Corporate strategy
	102-3	Location of headquarters	254	Contacts
	102-4	Location of operations	254	Contacts
	102-5	Ownership and legal form	58	Corporate strategy
	102-6	Markets served	58 182	Corporate strategy Financial overview and statements
	102-7	Scale of the organization	58 182 128	Corporate strategy Financial overview and statements Personnel management
	102-8	Information on employees and other workers	128	Human resources management
	102-9	Supply chain	138	Effective procurements
	102-10	Significant changes to the organization and its supply chain	-	There were no significant changes during the reporting period
	102-11	Precautionary Principle or approach	158 134 170 178	Risk management in Naftogaz Group in 2020 Occupational health and safety (OHS) Environmental protection Energy efficiency
	102-12	External initiatives	128	Human resources management
			178	Energy efficiency
			-	NJSC “Naftogaz of Ukraine” has joined the Global Voluntary Industrial Initiative for an enhanced system for monitoring, reporting and reducing methane emissions (Partnership in Combating Methane Emissions from the Oil and Gas Sector / Oil and Gas Methane Partnership 2.0) The Oil and Gas Methane Partnership (OGMP) 2.0. Ukrgasvydobuvannya has joined the UN Global Compact.
	102-13	Membership of associations	-	The company is a member of such organizations: - International gas union; - European energy forum; - Eurogas - EFET
GRI 102: General Disclosures 2016. Strategy	102-14	Statement from senior decision-maker	6	Address of Supervisory Board Chair
GRI 102: General Disclosures 2016. Ethics and integrity	102-16	Values, principles, standards, and norms of behavior	-	Code of Ethics
GRI 102: General Disclosures 2016. Governance	102-18	Governance structure	146 148	Corporate governance Report of Naftogaz supervisory board
		Remuneration policies	146 148	Corporate governance Report of Naftogaz supervisory board

Material topic	Disclosure number	Disclosure title	Page number	References and comments
GRI 102: General Disclosures 2016. Stakeholder engagement	102-40	List of stakeholder groups	-	Procedure for Interacting with Stakeholders (http://www.naftogaz.com/files/official_documents/Procedure_for_Interaction_with_Stakeholders_UA.pdf)
	102-41	Collective bargaining agreements	128 -	Human resources management The collective agreement covers all full-time employees of the company
	102-42	Identifying and selecting stakeholders	246	About the report
			-	Code of Ethics (http://www.naftogaz.com/files/HR/Naftogaz-Kode-Ethics.pdf)
			-	Procedure for Interacting with Stakeholders (http://www.naftogaz.com/files/official_documents/Procedure_for_Interaction_with_Stakeholders_UA.pdf)
	102-43	Approach to stakeholder engagement	246	About the report
			-	Code of Ethics (http://www.naftogaz.com/files/HR/Naftogaz-Kode-Ethics.pdf)
			-	Procedure for Interacting with Stakeholders (http://www.naftogaz.com/files/official_documents/Procedure_for_Interaction_with_Stakeholders_UA.pdf)
	102-44	Key topics and concerns raised	246	About the report
	102-45	Entities included in the consolidated financial statements	182	Human resources management
GRI 102: General Disclosures 2016. Reporting practice	102-46	Defining report content and topic Boundaries	246	About the report
	102-47	List of material topics	246	About the report
	102-48	Restatements of information	-	There were no restatements of information provided in previous reports
	102-49	Changes in reporting	-	There were no significant changes from previous reporting periods
	102-50	Reporting period	-	2020 calendar year
	102-51	Date of most recent report	-	July 13, 2020
	102-52	Reporting cycle	-	Annual reporting
	102-53	Contact point for questions regarding the report	-	Aliona Osmolovska, Naftogaz Group director of GR and stakeholder relations
			-	Tel.:+380 44 586 3579 Mob.:+380 73 335 80 53 press@naftogaz.com
			-	6 B. Khmelnytskoho st. Kyiv, 01601, Ukraine www.naftogaz.com www.naftogaz-europe.com
	102-54	Claims of reporting in accordance with the GRI Standards	-	This report was prepared in accordance with GRI Standard, “Core” level
	102-55	GRI content index	246	About the report
	102-56	External assurance	-	This report has not been independently verified

Material topic	Disclosure number	Disclosure title	Page number	References and comments
GRI 200: Economic topics				
GRI 201: Economic Performance 2016	GRI 103: Management Approach 2016		58	Corporate strategy
	201-1	Direct economic value generated and distributed	58	Corporate strategy
	201-4	Financial assistance received from government	-	Naftogaz did not receive financial support from the government in the reporting period
GRI 202: Market Presence 2016	GRI 103: Management Approach 2016		128	Human resources management
	202-1	Ratios of standard entry level wage by gender compared to local minimum wage	-	This information is confidential and is not disclosed by the Company. Instead, the report provides comparison of the wage growth across the company and across Ukraine
GRI 203: Indirect Economic Impacts 2016	GRI 103: Management Approach 2016		164	Local community development
	203-1	Infrastructure investments and services support-ed	164	Local community development
GRI 204: Procurement Practices 2016	GRI 103: Management Approach 2016			Effective procurements
	204-1	Proportion of spending on local suppliers	138	Effective procurements
GRI 207: Tax 2019	GRI 103: Management Approach 2016		182	Financial overview and statements
	207-1	Approach to tax	182	Financial overview and statements
	207-2	Tax governance, control, and risk management	182	Financial overview and statements
	207-3	Stakeholder engagement and management of concerns related to tax	182	Financial overview and statements
	207-4	Country-by-country reporting	182	Financial overview and statements
GRI 300: Environmental topics				
GRI 302: Energy 2016	GRI 103: Management Approach 2016		178	Energy efficiency
	302-1	Energy consumption within the organization	178	Energy efficiency
	302-3	Energy intensity	178	Energy efficiency
	302-4	Reduction of energy consumption	178	Energy efficiency
GRI 303: Water and Effluents 2018	GRI 103: Management Approach 2016		170	Environmental protection
	303-1	Interactions with water as a shared resource	170	Environmental protection
	303-2	Management of water discharge-related impacts	170	Environmental protection
	303-3	Water withdrawal	170 -	Environmental protection All water selected by the company is fresh (mineralization rate is 100 mg / l of total dissolved solids)
	303-4	Water discharge	170	Environmental protection
	303-5	Water consumption	170	Environmental protection
GRI 304: Biodiversity 2016	GRI 103: Management Approach 2016		170	Environmental protection
	304-2	Significant impacts of activities, products, and services on biodiversity	170	Environmental protection

Market and reforms

Strategy: How our business operates

Transformation: How we work

Corporate governance

Corporate social responsibility

Financial overview and statements






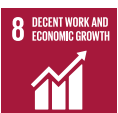






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Material topic	Disclosure number	Disclosure title	Page number	References and comments
GRI 305: Emissions 2016	GRI 103: Management Approach 2016		170	Environmental protection
	305-1	Direct (Scope 1) GHG emissions	170 -	Environmental protection Greenhouse gas emissions in CO2 equivalent are calculated on the basis of the IPCC global warming potential ratios presented in its Second Assessment Report (100-year period)
	305-7	Nitrogen oxides (NOX), sulfur oxides (SOX), and other significant air emissions	170	Environmental protection
GRI 306: Waste 2020	GRI 103: Management Approach 2016		170	Environmental protection
	306-1	Waste generation and significant waste-related impacts	170	Environmental protection
	306-2	Management of significant waste-related im-pacts	170	Environmental protection
	306-3	Waste generated	170	Environmental protection
	306-4	Waste diverted from disposal	170	Environmental protection
GRI 307: Environmental Compliance 2016	GRI 103: Management Approach 2016		170	Environmental protection
	307-1	Non-compliance with environmental laws and regulations	170	Environmental protection
GRI 400: Social topics				
GRI 401: Employment 2016	GRI 103: Management Approach 2016		128	Human resources management
	401-1	New employee hires and employee turnover	128 -	Human resources management Indicator has been partially disclosed
	401-2	Benefits provided to full-time employees that are not provided to temporary or part-time em-ployees	128	Personnel management At most of the enterprises of the Naftogaz Group, social benefits are provided to full-time employees, as well as to non-working retirees of the company. Protests, part-time, temporary or part-time employees are not provided and are not provided to social groups in general, which are provided for full-time employees (listed in the section of the report).
GRI 402: Labor/Management Relations 2016	GRI 103: Management Approach 2016		128	Human resources management
	402-1	Minimum notice periods regarding operational changes	-	According to the current legislation of Ukraine, such a period is 2 months. The relevant norm is enshrined in collective agreements

Material topic	Disclosure number	Disclosure title	Page number	References and comments
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) Health and safety issues are disclosed in a separate section of the collective agreement. During 2020, 8 appeals from citizens regarding occupational safety were made via the Naftogaz Group's hotline. The company provided reasonable answers to all appeals in the prescribed manner.
	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) Indicator has been partially disclosed
	403-9	Work-related injuries	134	Occupational health and safety (OHS) Indicator has been partially disclosed
	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 Indicators of the average number of training hours during 2020 per employee per article by company are given below: <ul style="list-style-type: none">• Ukrtransnafta: pers.- 2.19, female.- 2.74;• Ukrgasvydobuvannya: pers.- 8.6, female.- 3.0;• Ukrtransgaz: pers.- 2.7, female.- 0.8;• Ukravtogaz: pers.- 0.6, women.- 0.9;• Code of Civil Procedure: pers.- 16, female.- 14.
	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.

Material topic	Disclosure number	Disclosure title	Page number	References and comments
GRI 408: Child Labour 2016	GRI 103: Management Approach 2016		128	Human resources management
	408-1	Operations and suppliers at significant risk for incidents of child labor	-	Not relevant. Child and forced labour are prohibited by any applicable laws or regulations of Ukraine. The company does not operate in countries where there is a high risk of human rights violations, including use of child labour
GRI 409: Forced or Compulsory Labor 2016	GRI 103: Management Approach 2016		128	Human resources management
	409-1	Operations and suppliers at significant risk for incidents of forced or compulsory labor	-	Not relevant. Child and forced labour are prohibited by any applicable laws or regulations of Ukraine. The company does not operate in countries where there is a high risk of human rights violations, including use of child labour
GRI 413: Local Communities 2016	GRI 103: Management Approach 2016		164	Local community development
	413-1	Operations with local community engagement, impact assessments, and development programs	164	Local community development

Naftogaz Group's Initiatives for the SDGs

Goal	Chapter/Subsection in the Report	Page number
 Goal 1. NO POVERTY	Chief Executive Officer's Address (paragraph 5)	07
 Goal 3. GOOD HEALTH AND WELL-BEING	Naftogaz's response to COVID-19 pandemic Occupational health and safety (OHS) Local community development	014 134-137 165-168
 Goal 4. QUALITY EDUCATION	Human resources management Local community development	131-133 165-168
 Goal 6. CLEAN WATER AND SANITATION	Environmental protection	171-176
 Goal 7. AFFORDABLE AND CLEAN ENERGY	New Energy Energy efficiency	110-111 179-180
 Goal 8. DECENT WORK AND ECONOMIC GROWTH	Human resources management Occupational health and safety (OHS) Effective procurements/Procurement outcomes	128-131 134-137 140
 Goal 9. INDUSTRY, INNOVATION AND INFRASTRUCTURE	Exploration and Production division Technical division Oil Midstream and Downstream division PJSC Ukrnafta results	068-082 096-101 112-117 118-121
 Goal 11. SUSTAINABLE CITIES AND COMMUNITIES	Local community development	164-169
 Goal 12. RESPONSIBLE CONSUMPTION AND PRODUCTION	Energy efficiency	178-181
 Goal 13. CLIMATE ACTION	New Energy Environmental protection Energy efficiency	110-111 173-175 179-180
 Goal 15. LIFE ON LAND	Environmental protection/ Soil restoration and Biodiversity conservation	177
 Goal 17. PARTNERSHIPS FOR THE GOALS	Corporate strategy Exploration and Production division Retail business division Local community development	058-064 077-079 105-106 164-168



Contacts

Naftogaz of Ukraine
6 B. Khmelnytskoho St, Kyiv 01601 Ukraine
T. +380 (44) 586-33-30; 39-63; 32-83
ngu@naftogaz.com , press@naftogaz.com
www.naftogaz.com, www.naftogaz-europe.com
https://www.facebook.com/NaftogazUA
https://twitter.com/naftogazukraine

Ukr gasvydobuvannya
26/28 Kudryavska St, Kyiv 04053 Ukraine
T. +380 (44) 272-31-15, fax: +380 (44) 461-29-94
press@gasdob.com.ua
www.ugv.com.ua

Ukrnafta
3-5 Nestorivskyy Provulok, Kyiv 04053 Ukraine
T.: 0 800 404 000
office@ukrnafta.com
www.ukrnafta.com

Chornomornaftogaz
1 Sholudenka St, Kyiv 04116 Ukraine
T. +380 (44) 537-05-56
chernomornaftogas@ukr.net

Ukrtransgaz
9/1 Klovskyy Uzviz, Kyiv 01021 Ukraine
T.: +380 (44) 461-20-95
forletter@utg.ua
www.utg.ua

Ukrtransnafta
32/2 Moskovska St, Kyiv 01010 Ukraine
T.: +380 (44) 201-57-01/76, F: +380 (44) 201-57-78
office@ukrtransnafta.com
www.ukrtransnafta.com

Gas of Ukraine
1 Sholudenka St, Kyiv 04116 Ukraine
T: +380 (44) 537-05-38, F: +380 (44) 537-05-74
melnik@gasukraine.com.ua
www.gasukraine.com.ua

Ukravtogaz
2 Hryhorovycha-Barskoho St, Kyiv 03134 Ukraine
T.: +380 (44) 291-28-05/11
main@ukravtogaz.com
www.ukravtogaz.com

Ukrspetstransgaz
3 Promyslova St, Dolyna 03477 Ukraine
T.: +380 (3477) 2-53-10/11
trgaz@ustg.com.ua
www.ustg.com.ua

Naukanaftogaz
8 Kyivska St, Kyiv Oblast, Vyshneve 08132 Ukraine
T.: +380 (44) 391-74-01, F: +380 (44) 496-64-18
info@naukanaftogaz.com
www.naukanaftogaz.com

LLC Gas supply company “Naftogaz of Ukraine”
1 Sholudenka St, Kyiv 04116 Ukraine
T: +380 (44) 537-05-54, 0 800 215 515
customer@naftogazpostach.com
www.naftogazpostach.com

LLC Gas supply company “Naftogaz Trading”
1 Sholudenka St, Kyiv 04116 Ukraine
T: +380 (44) 364-76-54; 79-14
ngt@naftogaztrading.com.ua
www.naftogaztrading.com.ua

LLC Gas supply company “Naftogaz Teplo”
1 Sholudenka St, Kyiv 04116 Ukraine
T: +380 (44) 537-00-43; 05-53
info@naftogazteplo.com.ua
customer@naftogazteplo.com.ua
www.naftogazteplo.com.ua

Zakordonnaftogaz
72 Velyka Vasylkivska St, Kyiv 03150 Ukraine
T.: +380 (44) 237-64-65
office@nopc.org.ua

Office in the Arab Republic of Egypt
3 A ST. 259, New Maadi Cairo, 11311, Egypt
тел.: +202 27543365, +202 25202661
infoEG@naftogaz.com
www.naftogaz.com, www.naftogaz-europe.com/en

Office in the Kingdom of Belgium
Rue Breydel, 40, Brussels, 1040, Belgium
тел.: +32 2 235 8645/44
infoEU@naftogaz.com
www.naftogaz.com, www.naftogaz.eu

Office in the Federal Republic of Germany
Prinzregentenstraße, 54, 80538, München
T.: +49 (0) 89 5880 8466 2
+49 (0) 89 5880 8466 0
InfoDE@naftogaz.com

Office in Turkmenistan
ş.Aşgabat, Arçabil şaýoly, Biznes-Merkezi «ABC»
тел.: +99 312 48 01-86; 03-10
infoTN@naftogaz.com
www.naftogaz.com, www.naftogaz-europe.com

Naftogaz Trading Europe S.A.
rue Dr-Alfred-Vincent 16, c/o SYNERGIX S.A.,
succursale de Geneva, 1201 Geneva, Switzerland
тел.: +41 22 735 3805, +41 22 735 3807
infoCH@naftogaz.com
www.naftogaz.com

BCS – booster compressor stations, which maintain the pressure necessary for production at the final stage of field development
BP – British Petroleum, a transnational oil and gas, petrochemical and coal corporation
CABINET OF MINISTERS – The Cabinet of Ministers of Ukraine
COMPANY – Naftogaz
CRIMEA – The Autonomous Republic of Crimea, a region of Ukraine currently occupied by the Russian Federation
DHC – district heating company (same as “teplokomunenergo”)
DSNS, SESU – State Emergency Service of Ukraine
EBRD – European Bank for Reconstruction and Development
EC – the European Commission
EIB – European Investment Bank
EFET – European Federation of Energy Traders
EGPC – Egyptian General Petroleum Corporation
ENERGY MINISTRY – the Ministry of Energy and the Coal Industry of Ukraine
EU – the European Union
EUSTREAM – Slovak gas transmission system operator
GAS – natural gas, unless stated otherwise
Gas trunk pipelines –a single-line system feeding into the common system of gas pipelines, through which gas is transmitted from the production site to consumers
GAZPROM – Public Joint Stock Company Gazprom, a Russian energy company
GDS – gas distribution station
GMS – gas measuring station
GROUP – a group of companies that consists of NJSC Naftogaz of Ukraine, JSC Ukr gasvydobuvannya, JSC Ukrtransgaz, JSC Ukrtransnafta, LLC Naftogaz of Ukraine Gas Supply Company, LLC Naftogaz Teplo Gas Supply Company, LLC Naftogaz Trading Gas Supply Company, SC Gas of Ukraine, SE Uktavtogaz, JSC Chornomornaftogaz, OJSC Kirovohradgaz, SE Zakordonnaftogaz, JSC Ukrspetstransgaz, Naftogaz Overseas SA, SE Ukrnaftogazkomplekt, SE Naukanaftogaz, SE Naftogazobsluhovuvannya, SE LIKVO, SE Naftogazbezpeka, SE Budivelnik, PJSC Ukrnafta
GTS – gas transportation system
HF – hydraulic fracturing
IBRD – International Bank for Reconstruction and Development
IFRS – International Financial Reporting Standards
IMF – International Monetary Fund, a special UNO agency
LNG-TERMINAL – a liquefaction terminal, receiving and regasification of liquefied natural gas
LPG – liquefied petroleum gas
MHE – municipal heat generating entities
NAFTOGAZ OVERSEAS S.A. – JSC Naftogaz Overseas (Switzerland)
NEURC – National Commission for Regulation of Energy and Utilities
NOPLAT – adjusted operating result net of income taxes
OECD – Organization for Economic Co-operation and Development
OJSC KIROVOHRADGAZ, KIROVOHRADGAZ (KirGaz) – Open Joint Stock Company Kirovohradgaz, a regional gas distribution and supply company
JSC CHORNOMORNAFTOGAZ, CHORNOMORNAFTOGAZ (CNG) – Public Joint Stock Company Chornomornaftogaz

JSC UKRAVTOGAZ, UKRAVTOGAZ (UAG) – Joint Stock Company Ukravtogaz
JSC Ukr gasvydobuvannya, Ukr gasvydobuvannya (UGV) – Joint Stock Company Ukr gasvydobuvannya
PJSC UKRNAFTA, UKRNAFTA (UN) – Public Joint Stock Company Ukrnafta
JSC UKRSPETSTRANSGAZ,
UKRSPETSTRANSGAZ – Joint Stock Company Ukrspetstransgaz
JSC UKRTRANSGAZ, UKRTRANSGAZ (UTG) – Joint Stock Company Ukrtransgaz
JSC UKRTRANSNAFTA, UKRTRANSNAFTA (UTN) – Joint Stock Company Ukrtransnafta
PSO – public service obligations
PWC, PRICEWATERHOUSECOOPERS – international audit consultancy
ROIC – Return on Invested Capital. ROIC is calculated as NOPLAT for the respective year divided by invested capital, which was determined as a sum of invested capital in fixed assets and net working capital as of the end of the year
RSC – regional gas supply companies
RUSSIA – the Russian Federation
SE VUHLESYNTEZGAZ, VUHLESYNTEZGAZ – Subsidiary enterprise of National Joint Stock Company Naftogaz of Ukraine Vuhlesyntezgaz
STATE COMPANY GAS OF UKRAINE, GAS OF UKRAINE – a subsidiary of National Joint Stock Company Naftogaz of Ukraine
STATE ENTERPRISE ZAKORDONNAFTOGAZ,
ZAKORDONNAFTOGAZ – a subsidiary of NJSC Naftogaz of Ukraine
SUBSIDIARIES – subsidiary companies of National Joint Stock Company Naftogaz of Ukraine, including JSC Ukr gasvydobuvannya, JSC Ukrtransgaz, JSC Ukrtransnafta, SC Gas of Ukraine, SE Uktavtogaz, OJSC Kirovohradgaz, , SE Zakordonnaftogaz, JSC Ukrspetstransgaz, Naftogaz Overseas SA, PJSC Ukrnafta
TEPLOKOMUNENERGO – enterprises, producing heat and energy, district heating companies
UGS – underground gas storage
UNBUNDLING – separation of gas transmission from gas supply and production
URENGOY-POMARY-UZHGOROD GAS
PIPELINE (UPU) – the gas export route connecting the Urengoy gas field and northern gas fields of Western Siberia to Uzhhorod at the western border of Ukraine
USD – United States Dollar
WO – workover operations
WORLD BANK – the organization that provides assistance for development. It comprises two institutions: the International Bank for Reconstruction and Development (IBRD), and the International Development Association (IDA)

