

# **The role of Gazprom in the economy of Russian Federation**

**BY**

**Panagiota Fotiadou**

**A thesis submitted in fulfillment of the requirements for the degree of**

**MASTER IN POLITICS AND ECONOMICS OF  
CONTEMPORARY EASTERN AND SOUTHEASTER EUROPE**

**At the**

**UNIVERSITY OF MACEDONIA**

**2011-2012**

**Supervisor: Dimitrios Kyrkilis**

Contents.....2

Introduction.....3-6

## **Gas Sector and Pricing in Russia**

What is the Russian gas market structure?.....7-8

At what prices does Gazprom sell gas to Russian consumers? How are these prices set?.....9

Domestic Market Pricing in Russia .....10-11

Optimal Export Prices .....12-13

Regulated Russian Gas Market.....14

Developing Russian gas market in compliance with market-based principles.....15

Natural gas exchange.....16-17

Gas transmission system development in Russia.....17-18

Nord Stream and South Stream gas pipelines.....18-20

Developing exchange trade in natural gas.....20

## **Gazprom**

Why is Gazprom so important? .....21-24

Gazprom profile.....25-26

## **MAJOR RESULTS**

GAZPROM GROUP'S RESULTS & OAO GAZPROM'S RESULTS.....27-32

Conclusion.....33-34

Bibliography.....35-36

## Introduction

In recent years, Russia has been frequently described as an energy superpower. The term energy superpower is a term mainly used by media and politicians to refer to a nation that supplies large amounts of energy resources to a significant number of other states, and therefore has the potential to influence world markets to gain a political or economic advantage. This term is usually used to refer to Russia, but has been used also to refer to other countries. Energy superpower status might be exercised, for example, by significantly influencing the price on global markets, or by withholding supplies. Russia's reserves of natural gas and oil have helped give it the title of energy superpower.

In addition, energy, particularly petroleum and natural gas, is the most important export and source of foreign exchange for the Russian economy. Experts forecast that the energy sector will continue to occupy this central position until Russian manufacturing reaches a level competitive with the West.

Energy transformed Russia's fortunes after its decline during the 1990s. The wealth generated from energy exports actuated economic recovery and political stabilization, and has significantly contributed to Russia's assertiveness as a great power.

After the Russian financial crisis-ruble crisis, the U.S. Department of Commerce declared Russia a free-market economy. Only 12% of Russian enterprises are still owned by the state entirely. Russian government outlays as a percentage of GDP in 2000 stood at just 30%, the same as in the United States. In addition, President Vladimir Putin has cracked down on greedy oligarchs and welcomed foreign trade and investment. Four years after the collapse of the ruble and Russian economy, investors flocked back in droves and the Russian stock market jump to 90% in the past months.

But there is another test of the character of Russia's economy: the fate of the country's largest company, the natural gas giant Gazprom. Monstrously mismanaged, unaccountable to shareholders and politically well connected, Gazprom remains a challenge to the integrity of Russia's free-market economy. Moreover, it poses a challenge to Russian democracy itself, which needs to foster independent public institutions - like independent courts and regulatory agencies - and a private sector that truly respects property and the rights of shareholders.

Energy has been a key factor in shaping Russia's foreign relations in both the Eurasian and global context. The objective of the energy policy of Russia is to maximize the effective use of natural energy resources and the potential of the energy sector to sustain economic growth, improve the quality of life of the population and promote strengthening of foreign economic positions of the country.

Russia has not only a critical position in the global energy sector but in the global energy balance, too; because of its role as a leading producer and exporter of key energy reserves.

Analysts from the International Energy Agency have been discussing Russia's energy future in Moscow with key government and business leaders, including the top management at Russian natural gas monopoly Gazprom. In 2008, Gazprom's activities made up 10% of the Russian

GDP. The company also controls assets in banking, insurance, media, construction and agriculture. It is a vertically integrated company which dominates both upstream and downstream activities.

It is the largest Russian company which owns all main gas-processing facilities in Russia, operates the country's high pressure pipelines and has a legal export monopoly since 2006. Gazprom was created in 1989 when the Ministry of Gas Industry of the Soviet Union transformed itself into a corporation, keeping all its assets intact. Later, the company was partly privatized, but currently the Russian government holds most of the control in its hands.

Gazprom is Russia's largest joint stock company in terms of capitalization. The Russian Federation controls a 50.002% stake in the share capital of Gazprom. Gazprom shares are traded at Moscow Interbank Currency Exchange (Russia) as well as at London, Berlin and Frankfurt stock exchanges in the form of American Depositary Receipts. Furthermore, a great deal of shares is circulated in the U.S. over-the-counter market among qualified institutional buyers. The market capitalization of Gazprom as at the end of 2011 amounted to USD 128 billion.

Gazprom sells gas inside Russia considerably under the global market price as a form of subsidy to the public. However, this lower price also lets Gazprom to hit competition while presenting an image of enhancing Russian interests. The giant company belongs to the so-called national champions; a concept advocated by Russian president Vladimir Putin, in which large companies in strategic sectors are expected not only to seek profit, but also to advance Russia's national interests.

Given that, energy is likely to remain at the top of the global political agenda. This paper sets light on the importance of gas. The appropriate title of the dissertation is "**The role of Gazprom in the economy of Russian Federation**". The aim of the paper is to gain a better understanding of the importance of gas especially for the Russian market. We state the Russian gas transmission system development – including Nord Stream and South Stream gas pipelines which are the very famous ones. We start to examine Russian gas market structure and the pricing sector. It's of a great importance to analyze the prices that Gazprom sells gas to Russian consumers and how are these prices set. Also, we examine the Domestic Market pricing within the country. We take a look at the Optimal Export Prices. Regulated Russian Gas Market, Developing Russian gas market in compliance with market-based principles, Natural gas exchange, Developing exchange trade in natural gas; these are some other crucial issues that are under discussion in this paper. Suffice it to say, that Gazprom is heard to be gas giant and plays catalytic role in both Russian and global economic results. But why is Gazprom important? We answer this question, through its profile. After the company's profile analysis some Gazprom major results; operating and financial - Group's and OAO results are introduced in order to extend our aim.

Russian Federation Export restraints on natural gas have been the source of major controversy between the Russian Federation and the European Union. As part of the WTO accession negotiations of the Russian Federation the European Union has increased both quarrels. The natural gas dispute was solved as part of the bilateral agreement on Russian WTO Accession between the Russian Federation and the European Union. In the case of natural gas, the Russian Federation holds an export monopoly to Gazprom, allowing Gazprom to charge the profit raising prices on its exports.

However, Russian Federation regulates the domestic price of natural gas, resulting in double pricing of natural gas, where export prices have far overdrawn Russian domestic prices. The Russian Federation occupies monopoly power on natural gas exporting. This suggests that from the prospect of the economic welfare of Russia as a whole, some export restraint by the Russian Federation is optimal in natural gas. We can argue that the export restraints in natural gas very substantially benefit Russia and Russian domestic market for natural gas would be better served if the Russian government were to display competition.

A wide range of structural reforms in Russia are even more important now due to the lack of development of new gas supplies by Gazprom. This fact results in raised reliance on central Asian gas supplies and increased prices of gas for Russian consumers. As part of the energy strategy to vary its energy sources, the European Union has also sought competition in the Russian natural gas market. Competition among various gas suppliers from Russia would decay or eradicate the monopoly gas export profits of the Russian Federation. So, the Russian government would be expected to provide exclusive exporting rights to a single entity, as it presently does with Gazprom, or impose export taxes.

Europe should not anticipate achieving cheaper Russian gas through competition within Russia. A more auspicious boulevard for European energy diversification is the design of new pipeline to open up new sources of supply independent of Russia, especially the Nabucco pipeline project, and liquefied natural gas purchases.

During the accession negotiations to enter the WTO, the question arose whether Russia should hold the same price for the exports of its natural gas as it charges in its domestic market. This topic was much controversial in Russia and was a hot issue in the bilateral market access negotiations between Russia and the European Union.

From Russia's part, there is an intense sanity for discriminatory pricing between gas sold within the country for its residents and the exported gas. We assume that gas pipelines allow Gazprom to intersect the Russian market from the European including Turkish market. Besides, Russian market power in the European market is strong. It is in Russia's faith to take advantage of export markets' monopoly power by charging prices beyond its long run marginal costs. Concerning Russia's domestic natural gas markets, the Russian market would be better attended by competition.

The analysts suggest that as far as Gazprom remains a monopoly, Russia should regulate natural gas domestic prices so that gas producers recover the full long run marginal costs. These conclusions necessitate raising export prices; more than domestic prices of natural gas.

There have been many significant changes in the Russian gas market since the last decade. Considerable changes in the Russian domestic market have proved that the proposal to raise competition within the Russian gas market is even more outstanding today than it was formerly

in this decade. Nevertheless, the basic commencement that it is not in Russia's interest to integrate natural gas prices has not modified.

**World Efficiency;** At the other side, efficient pricing from the prospect of the world would yield for consolidated pricing of gas. One kind of pricing mechanism that could manage this optimum of consolidated pricing is a two part tariff pricing by Gazprom. However, analysts show, that two part tariff pricing could about to double the profits of Gazprom sales in the European market.

**Europe's Interest;** From the Europeans' side, rather than stress Russia in WTO negotiations, energy sources diversification is the proper way to put through more competitive energy prices. It seems that the most important of the several pipeline proposals under construction or discussion today is the Nabucco pipeline because it is severe to obliterate the monopoly power of Gazprom. Besides, the construction of Trans- Caspian pipeline would also be much helpful for Europe.

# Gas Sector and Pricing in Russia

---

## **What is the Russian gas market structure?**

The Russian gas market is separated into two sectors; regulated and deregulated. Independent gas producing and oil companies mostly supply the deregulated sector. Gazprom mainly supply the regulated sector which often outbalances and it's the dominator one.

The Government regulations:

-wholesale natural gas prices, which apply to natural gas sales by OAO Gazprom and its affiliated companies in the domestic market;

-tariff rates for the services provided for independent producers and related to natural gas transmission via gas mains and those related to natural gas transmission via gas distribution networks;

-charges for supply and marketing services.

Independent producers sell their gas at deregulated price and constitute around 1/4 of Russia's demand for blue fuel. Simultaneously, the Government stopped the price regulations of alternative fuels, especially those of coal and fuel oil, 12 years ago.

In 2007 the Russian Federation Government confirmed Directive No.333 for improving State Regulation of Gas Prices. This Directive declares a new pricing mechanism for gas supplied by Gazprom and anticipates setting a regulated price limit-minimum and maximum price levels-for different consumer groups. The minimum price levels became the fixed gas prices set by the Russian FTS. The maximum price levels are set forth by this confirmed Directive. In January 2011, the excess percentage of the maximum wholesale prices over the fixed regulated prices was defined as 10%. Suppliers and buyers are granted with the benefit to determine gas prices within these limits.

This pricing procedure is pertained to new consumers that sign their first supply contract after July 2007 and to natural gas supplies over the contracted volumes. Long-term gas supply contracts play a fundamental role in the Russian gas market development.

Both suppliers and prominent gas consumers are benefited from long-term contracts. Due to the regulated method, the market based pricing method fixed in contracts provide more flexibility in adapting prices to gas consumption levels by a range of industries. Moreover, it provides seasonal fluctuations as great as consideration, over agreement with specific consumers, of factors such as price variations depending on the supply schedules, off-take patterns during one day or more.

The world gas market development experience shows that long-term contracts can continually ensure gas deliveries to the consumer and investments needed for the gas industry development to the producer. The equilibrium of interests of natural gas consumers and producers in Russia will be accomplished in the procedure of wider application of market based gas pricing methods in line with the state regulation of tariffs for gas transmission services. The Government Decree defined December 2010 No.1205 on Streamlining State Regulated Gas Prices set the task to transfer in 2015 from the state regulated wholesale gas prices to state regulated tariffs for gas transmission through the gas pipelines in Russia.

### **Gazprom in Russian Market**

282.1	billion m3	in 2001
283.5	billion m3	in 2002
291	billion m3	in 2003
305.7	billion m3	in 2004
307	billion m3	in 2005
316.3	billion m3	in 2006
307	billion m3	in 2007
287	billion m3	in 2008
262.6	billion m3	in 2009
262.1	billion m3	in 2010
265.3	billion m3	in 2011

Source: Gazprom official site

<b>Gasification level in the Russian Federation:</b>			
54.20%	in	2005	
63.20%	in	2011	

Source: Gazprom official site

## **At what prices does Gazprom sell gas to Russian consumers? How are these prices set?**

In Russia wholesale prices for gas extracted and supplied by OAO Gazprom and its affiliates are annually set by the Russian state represented by the Federal Tariff Service (FTS). The wholesale regulated price for natural gas delivered to Russian consumers in 2011 averaged RUB 2,746.7 per 1,000 m<sup>3</sup> (net of VAT). Moreover, the Government Directive No.333 of May 28, 2007 authorized Gazprom to supply certain consumers with gas at prices in line with contract with the upper price level fixed by the FTS.

Every gas sale at the wholesale price gives to Gazprom revenues. Revenues of gas distribution companies transmit gas to consumers through gas distribution networks which are formed through regulated transmission tariffs. Regional gas trading enterprises receive charges for supply and marketing services rendered and administrations of the Russian constituents set the retail gas prices for the population. These prices had specific characteristics such as appropriate pricing for consumer groups with privileges. Also, in case of no gas meters in the residence, charges calculated by the basis of established standards.

Gas is the most widely used fuel and the cheapest one in Russia and the share in the primary energy mix of the Russian economy is over 50 %. As a result, top-heavy fuel balance menaces national energy safety as other fuel alternatives such as fuel oil, peat and coal tend to stagnation and efficient utilization of this non-renewable natural resource does not cause stimulation.

Regulated gas prices are underestimated. Due to this, until 2009 covering gas production, transmission and marketing costs faced obstacles. Such prices impede the gas industry development but ultimately restrained the formation of the Russian economy efficient structure.

Due to cheap energy supplies, the Gazprom subsidized companies have no stimuli to cut operating expenses. Cheap gas drove to minimized competition for the new eco-friendly fuels and energy conservation technologies. The most gas-consuming economy in the world is the Russian one.

The most industrial countries the greatest bulk of the gas is consumed by households. But in Russia gas is primarily supplied to power generating companies, metallurgical and chemical industries. Also, a long-term delivery of cheap gas to Russian export-oriented producers is demonstrated as unjustified export subsidy. So, the domestic market-the primary sales market couldn't provide funds to the Company's new projects for large-scale field development, capacity augmentation and building new gas pipelines as well as Russian regions gasification. This irregular situation has lasted many years and was.

For a better result, in recent years, the Russian Federation Government has been following a policy of systematically increasing gas prices to an economically substantiated level as well as expanding opportunities for the market based pricing principles application.

## **Domestic Market Pricing in Russia**

Many years after independence of Russia Gazprom had a virtual monopoly on domestic gas sales. However, the Federal Tariff Service of the Russian Federation regulates the price of gas sales in the country. Besides, Gazprom controls the gas pipeline within the country. In a legal way, third Party Access to the pipelines is granted in Russian law to Russian independent gas producers. These producers are both vertically integrated oil companies and particularly specialized gas companies.

As a matter of fact, independent gas producers often complain about their access. Nevertheless, the shares of the Russian market conceived by independent gas producers in Russia have risen perpetually since 2002, and constantly launched an estimated 12-15% of the Russian market in 2008.

Furthermore, independent gas producers manage almost 30% of the natural gas reserves.

Gazprom is clearly a very prevalent firm with remarkable and appreciable monopoly power within Russia's domestic market and outside. Efficient regulation requires limiting the action of that monopoly power until more effective competition is inserted into the Russian market. In such a case, efficient regulation of monopolies requires a domestic market price at levels that mirror the real alternate economic value of the commodity.

In case of a world price extinction, the opportunity costs of selling gas in the Russian domestic market would be the world price and it would be optimal for Russia to charge a unique price on its sales; both export and domestic. There is not a world price of natural gas for Russia. As a consequence, Gazprom must designate its export price independently of its domestic price. Then, the opportunity costs agree with the natural gas long run marginal costs in Russian domestic market.

In 2001, this necessitated that it was indispensable for Russia to increase the domestic price of natural gas in order to reach this economically efficient price; if this didn't happen, the capital stock will aggravate and supplies will not come time over time. We must mention that, as a matter of fact, many market economies regulate the maximum price of monopolies such as gas and electricity distribution in order to achieve this pricing target.

If Russia have permitted Gazprom to increase its natural gas domestic prices from about \$15 to \$20 per TCM (prices of 2001) to the full long run marginal costs; about \$35 to \$40 per TCM, Russia would have benefited and could earn approximately \$1.24 billion dollars annually.

By the forthcoming years, natural gas prices in Russia had grown somewhere between \$64 and \$72 per TCM. This was the consequent result of inflation and the essential increase in steel and wage costs beyond the rate of inflation, coupled with the weaker dollar. It seems, however, that with that essential raising of natural gas price to Russian producers, prices are much closer to Long Run Marginal Cost in 2007. Besides, in May 2007, the Government of Russia declared an action plan to raise the price of natural gas to industrial users to international levels by 2011, decreasing transportation costs and export taxes.

In the beginning of 2008, the prices on exports to Europe reached approximately \$378 per TCM. Estimating transportation costs of about \$35 per TCM and export taxes at 30%, to precede this plan in this period, prices in Russia would have to rise to about \$225 per TCM. Due to Russian government provisions, domestic natural gas prices in 2011, however, were that prices would rise to about \$120 per TCM.

In this way, to carry out this plan in success, Russian domestic market prices would have to rise significantly more than the rate which was planned. More significantly, such high domestic prices would be very insufficient and ineffective. High prices would urge very outstanding depletions and conversions in Russian demand, to the level where the value to Russian consumers would be quite bigger than the long run marginal costs of production.

All this matter would signify substantial monopoly profits for Gazprom on domestic sales. Russia struggled with hard negotiations against the WTO and finally won the right to have dual pricing of natural gas. Nevertheless, all but the 30% export tax difference and the transportation fees, Russian valid plans request to consolidate natural gas prices for its industrial users.

## Optimal Export Prices

It is Russia's concernment to attempt maximizing its natural gas export profits.

Taking into account the need to consign natural gas from Russia to Europe via a pipeline, Russia has the possibility to intersect the European market from the Russian market.

In 2008, Russia had a market share of almost 28% of natural gas sales in Europe. Furthermore, in the same year, Europe and Turkey consumed approximately 547 billion cubic meters of natural gas. 154 BCM were imported from Russia.

This entails that Russia exerts some kind of market power in Europe. The Russian government has authorized Gazprom with the exclusive privilege to make use of the pipelines for the export of natural gas to Europe. In this state, pricing beyond long run marginal cost is the most suitable for Gazprom in order to utilize this market power.

In other words, given the fact that the role it plays in supplying the European market is remarkable, Gazprom has market power. However, the market power's length is tempered by the occurrence of competing sources of gas. Also, Gazprom wants to make profit from being apprehended as a credible supplier that can be confided to keep on delivering gas; potentially in augmenting quantities at an equitable price to European markets.

Over time, Gazprom contemplates risks that new competitors will decay its market share and those risks are more serious the higher its markup over marginal costs. For the next coming years, the growth is hampered by transportation facilities and long-term contracts. Although this restriction can be defeated and new entrants are probably to come out, the longer-term limitation is the demand of export markets. Russian confirmed reserves are adequate to support a doubling, or even tripling, of its production capacity. In order to engross this bulk of gas, European markets would have to rise significantly.

The fundamental spot here is that Gazprom is not able to sell importantly more natural gas in European markets without affecting the gas price there. In 2008, the domestic consumption of 420 BCM in Russia was 2.7 times Gazprom sales in Europe.

Gazprom would have to accept a lower price, in order to sell notably more gas; i.e. it faces a downward sloping demand curve. This means that there is no "world price" of gas that Russia faces. Better saying, Gazprom must figure the best price for its gas sales in Europe that mirror the tradeoff it faces between the additional revenue from extra sales of gas and the lost revenue from the reduction of price to sell additional gas. As well as the demand for gas in Europe alters, Gazprom's optimal gas price in Europe will have to transform time over time but it is in Gazprom's concern to maximize its exports profits.

We can presume that Gazprom is optimizing the quantity and the price that is sold in Europe; in 2000 and 2001 this was between \$79 and \$99 per thousand cubic meters (TCM) plus \$27 transport costs. In 2008, the prices were approximately \$380 per TCM.

On one hand, specialists disclose that if Russia were to sell its natural gas to Europe at only full long run marginal cost plus transportation costs, Russia would lose between \$5 billion and \$7.5 billion per year at 2001 values. On the other side, European consumers would earn even more somewhat between \$7.5 billion and \$10 billion per year, as they would consume at lower prices more gas.

Instead, in case Russia were to increase its domestic prices to the prices it charges in Europe, Russian industry would undergo dramatically adjustment costs as the gas cost augments would negatively impinge on investment and unemployment in the short run. Assimilating the cost increases would urge Russian industry to shift to alternating fuels and produce less gas strenuous products that cannot be justified on the principle of Russia's comparative advantage.

## Regulated Russian gas market

Gazprom's try to achieve sustained gas supplies for the domestic market in line with increasing sales profitability. Gazprom sees Russia as the largest and potentially most attractive gas market. Gazprom sells more than a half of its marketable gas domestically. In 2010 the Group's proceeds from domestic gas sales (net of VAT and excise) grew by 24% versus 2009 to RUB 614.7 billion. The sales volumes amounted to 262.1 billion cubic meters (262.6 billion cubic meters in 2009). At present, the Russian market subsumes two sectors: regulated and deregulated. The regulated sector is predominant. Gazprom is the major supplier in this sector.

<b>Domestic gas sales</b>			
	<b>2008</b>	<b>2009</b>	<b>2010</b>
Average gas price (net of VAT and excise)	RUB 1,652.8 per 1,000 m3	RUB 1,855.0 per 1,000 m3	RUB 2,345.5 per 1,000 m3
Sales volumes	287 billion m3	262.6 billion m3	262.1 billion m3

Source: "Domestic gas sales" by Gazprom Group

Gas produced by Gazprom according to the Russian Federation Laws and Government Directives is marketed to domestic consumers fundamentally at state-regulated prices. The variation parameters for regulated entire sale gas prices are defined by the Russian Government.

The Federal Tariff Service (FTS) of Russia approves specific regulated wholesale prices for various price zones with due regard to consumer alienation from gas production areas and to consumer categories. Administrations of the Russian constituents set retail gas prices for the population.

Population	19%
Power industry	30%
Utility sector	15%
Agro chemistry	7%
Metallurgy	7%
Cement industry	2%
Others	20%

Source: Gazprom official site (marketing)

## **Developing Russian gas market in compliance with market-based principles**

From 2006 the Russian Federation Government has been making improvements on developing the Russian gas market in line with market-based principles. In 2007 the Russian Federation Government established Directive No.333 setting out a number of actions aimed at pricing liberalization in the gas industry. Particularly, Gazprom was authorized to supply gas to a certain consumer group at contract prices, while the FTS regulates the upper price threshold. In 2010 the Russian Federation Government established Directive No.1205. The Document refers to a transition period from 2011 to 2014 when regulation of wholesale gas prices-for all consumers but population will be on the basis of a price formula consorting with gradual transition to equal profitability of export and domestic gas sales in exchange given to the cost of fuel alternatives.

Moreover, transition to equal profitability between 2011 and 2014 is asserted by special discount rates integrated by the Federal Tariff Service into the formula and bringing the price level in accordance with the Russian Government create average parameters of changes per annum in wholesale gas prices for all consumers but for the population.

Furthermore, special rates that differentiate natural gas prices for various constituents of the Russian Federation will be set up by Russia's FTS. In addition, between 2013 and 2014 the gas price for range of consumers may differentiate from minus 3 per cent to plus 3 per cent of the average value in the region.

Due to Directive No.1205, specialized authorities have to tabulate the process of wholesale gas pricing within the transition period and submit a proposal to the Russian Federation Government on the transition. To be more specific, transition from state regulation of wholesale gas prices to state regulation of tariffs for gas transmission through gas trunk lines in the Russian Federation beginning from 2015.

A shift to domestic gas pricing based on the market principles will create the appropriate environment which the domestic gas market will be the guideline for sustainable development of the gas sector and related industries for the energy efficiency increase in the national economy.

## Natural gas exchange

Nowadays, Gazprom is involved in natural gas exchange trade on the domestic market arrangements and streamlining the gas trade process through the ETP of Gazprom Mezhrefiongaz.

A draft Directive on Gas Trade Using Exchange Technologies was proposed to the Russian Federation Government for consideration. The document was composed to reserve transition from experimental gas trade by Gazprom at deregulated prices to exchange trade technologies utilization on a regular basis.

Gas marketing on the basis of exchange trade technologies is seen as a mechanism of a market for optimizing gas sales to correspond to the consumer demand through a range of supply modes and creating an objective and transparent gas benchmarking system. The natural gas exchange is designated for financial instruments trade, primarily futures contracts, with real gas delivered at the participants' request and upon the contract maturity.

Due to specialists, a provider of clearing and settlement services for exchange traders is an important element of the natural gas exchange infrastructure. An appropriate subsidiary of Gazprombank - Settlement and Depository Company - dealing with the clearing operations on the commodity market, with a pool of the authorized banks selected from the major Russian financial institutions, assure settlement of the transactions performed in parallel with natural gas in Russian rubles and under the Russian jurisdiction. Professionals mention "It is essential that both structures (ETP and natural gas exchange) can perform efficiently complementing each other".

The Russian Federation Government empowered Gazprom and its affiliated companies, being the main producers and suppliers of natural gas, with a right to trade gas through the ETP and the natural gas exchange at free market prices. This constitutes one fundamental stage of beginning exchange trade in natural gas. To mention that, gas distribution companies (GDC), subsidiaries of Gazprom Group, own and service over 478.9 thousand kilometers of gas networks, while the Group's affiliate GDCs own and service over 153.8 thousand kilometers as of the end of 2010. The subsidiary and affiliated GDCs convey 173.4 and 51.6 billion cubic meters of natural gas a year via distribution pipelines, respectively.

<b>Gas distribution pipelines length in Gazprom Group, thousand kilometers</b>	
2007	544.5
2008	586.8
2009	611.8
2010	632.7

\*The distance from Earth to moon is 384.5  
Source: Gazprom official site (Marketing)

Also, a streamline tax legislation, especially, to reconsider the mechanism of determine the amount and the payment process for value added and income taxes on commodity futures trade is needed. Thus, an exchange trade system in Russia in accordance with the relevant practices of the world's leading commodity exchanges will be set up.

Initially, the natural gas exchange is supposed to service Russian domestic market. Later, as the capacity of natural gas export facilities is increased and natural gas markets in the CIS and EU are liberalized, the natural gas exchange will spread its activities to foreign markets.

## **Gas transmission system development in Russia**

**The Bovanenkovo - Ukhta gas trunkline system** is the first principle of a multi-line gas transmission system aimed to retract gas from the Yamal Peninsula fields and transport gas from the field of Bovanenkovskoye to the UGSS. The Bovanenkovo–Ukhta gas trunkline system includes two 1,100 km linear sections and one four-line 71km long submerged section across the Baidarata Bay. Till now, the linear part of the first gas pipeline string and one compressor station have been constructed and construction of the second string has started.

**The Ukhta - Torzhok gas pipeline** will cross Vologda and Arkhangelsk regions and it will become a part of the gas transmission system to transmit Yamal gas to the Gryazovets gas transmission hub in Northwestern Russia. The gas pipeline building was established in 2011. The gas pipeline section between Ukhta and Gryazovets is going to be put on stream during this year.

**The Gryazovets - Vyborg gas pipeline** is a branch pipeline of the Northern Lights pipeline from Gryazovets in central part of Russian Federation through Vologda and Leningrad oblasts to Saint Petersburg, Vyborg, and Finland. The linear part of the gas pipeline has already been charged. Construction of the looping system within the linear part as the gas pipeline's compressor stations is wavering. Capacities are being laid to the Portovaya compressor station (CS) - the outset of the Nord Stream gas pipeline. The Portovaya CS will become a unique gas transmission facility having no domestic analogues by its capacity and working pressure.

**The Pochinki - Gryazovets gas pipeline** at the first stage, secures extra gas supplies to the Northwestern region and, inter alia, delivers gas to the Nord Stream gas pipeline. At the next stage, when natural gas transmissions from Yamal are set off, the pipeline will be shifted to reverse flow and gas will be rerouted to the Central region. The pipeline's linear part and the three compressor stations are ready.

**The Northern Tyumen Regions (SRTO) - Torzhok gas pipeline** is planned to convey more gas to consumers in Northwestern Russia and secure export supplies through the Yamal - Europe gas pipeline. Till now, the 2,200 km linear part and 10 out of 13 compressor stations have been authorized. The rest of compressor capacities are planned to be put into action with the Bovanenkovo - Ukhta gas pipeline at the same time.

**The Sakhalin - Khabarovsk - Vladivostok gas transmission system (GTS)** is major priority project within the Eastern Gas Program. The successful project of the Sakhalin – Khabarovsk –

Vladivostok gas pipeline's first start-up complex has heralded the beginning of an integrated gas production, transportation and supply system, which will link eastern Siberia and the Far East, while maintaining possibilities for potential gas exports to China and other Asia-Pacific countries. The first beginning complex facilities of the GTS were put into action in September 2011. Gas supplies to consumers in Vladivostok were carried forward.

**The Dzhubga - Lazarevskoye - Sochi gas pipeline** has been part of the Russian Government approved Program for Construction of Olympic Venues and Development of Sochi as a Mountain Climate Resort. The route of pipeline lies under the Black Sea along the coastline to the Kudepsta gas distribution station which is near Sochi. This pipeline was empowered in June 2011.

**The Southern Corridor gas pipeline system** will be able to supply extra natural gas volumes to Russia's central and southern regions in order to ensure unceasing gas supplies into the South Stream gas trunk line. It is designed to construct around 2,500 km of gas trunk lines and 10 compressor stations within the project. The project will be finished before December 2019 and separated into two phases: 1. Western Part (over 800 km long); 2. Eastern Part (over 1,600 km long). Till now, documents have been elaborated only for the first phase of the project.

**The Altai gas pipeline which is projected** will be able to secure gas transmission to the western part of the Russian - Chinese border with the aim to supply Russian gas to China through the western route-if commercial agreements are succeeded.

### **Nord Stream and South Stream gas pipelines**

As well as we talk about Russian gas we must mention the Nord Stream and South Stream gas transmission projects. These projects enable the openness of fundamentally new routes for Russian gas deliveries to Europe in order to improve European energy safety.

**The Nord Stream** gas extends 1,224 km across the Baltic Sea from the Portovaya Bay near Vyborg to the German coast near Greifswald. The new gas dominant will annually supply over 55 billion m<sup>3</sup> of Russian gas to European consumers.

Nord Stream project has been included into the list of the top-priority energy projects of the Trans-European Energy Network by the European Union. Through this project, Gazprom becomes enable to vary export flows and link Russia's gas transmission networks with the European gas network directly. Nord Stream has a distinctive element; it gets around transit countries, and this decreases third-party risks and Russian gas transmission costs as increases the credibility of gas export. The gas pipeline also ought to sprawl gas supply to Russia's Northwestern Federal District.

In 2005 OAO Gazprom, BASF SE and E.ON AG entered the principle Agreement on the Nord Stream gas pipeline construction. Dutch Gasunie and French GDF SUEZ joined the project in 2008 and 2010 at the same time. Now, the shareholding structure of Nord Stream AG, being the gas pipeline construction operator, is: 51 % - OAO Gazprom, 15.5 % - Wintershall Holding

(BASF SE subsidiary) and 15.5 % - E.ON Ruhrgas, 9% - N.V. Nederlandse Gasunie and 9 % - GDF SUEZ.

Construction of the UGSS sections in Northwestern Russia, in order to supply gas through Nord Stream, started in 2005. The Nord Stream gas pipeline construction in the Baltic Sea was initiated in 2010. In 2011 the first gas pipeline string was delegated. The commercial gas supplies to European consumers were advanced. In 2010 the second string of the gas pipeline was being part of the schedule. The second string of Nord Stream will increase the gas pipeline capacity from 27.5 to 55 billion m<sup>3</sup>. In 2012 whole load testing was completed at Nord Stream successfully. The first gas pipeline string was operational entirely charged during three days supplying 75 million m<sup>3</sup> of gas per day that equated to the annual designed capacity of 27.5 billion m<sup>3</sup>.

**The South Stream** transnational gas pipeline project stares the distribution of Russian blue fuel across the Black Sea to Southern and Central Europe.

The gas pipeline will lay under the Black Sea from the Russkaya compressor station in Russia to the Bulgarian coast and further across European countries. The length of the Black Sea section will be 900 km totally and the maximum depth - 2,250 m. The pipeline's offshore section planned capacity is 63 billion m<sup>3</sup>. Also, there are three optional routes for the onshore gas pipeline beyond Russia: to Baumgarten - Austria through Bulgaria, Serbia and Hungary, to Northern Italy through via Bulgaria, Serbia, Hungary and Slovenia, to the Southwestern route - Greece and Italy.

Gas costals may be deviated from the main route of the South Stream onshore part in Europe to Croatia and Macedonia, the second one starting in Bulgaria. Moreover, Montenegro and Republika Srpska are the potential partners of the project. The decision was made to create expediency studies for the gas costal construction in these countries.

Intergovernmental agreements with Bulgaria, Hungary, Greece, Serbia, Slovenia, Croatia and Austria on the project implementation were signed between 2008 and 2010. Bilateral cooperation agreements were signed by OAO Gazprom aiming to precede the project together with the commissioned national companies of these countries. Collective project companies were erected for the operation of the gas pipeline in the relevant countries - project partners, for engineering and subsequent construction.

In 2011 national expedience studies for the gas pipeline's separate sections was incorporated in cooperation with the authorized companies. In the same year, the Consolidated Feasibility Study of South Stream was settled. It included an expediency study of the offshore section and expediency studies of the gas pipelines in the host countries of Southern and Central Europe.

Besides, in 2011, the Shareholder Agreement of the new project company-South Stream Transport AG was established for the offshore project section performance. Compatible to the document, OAO Gazprom holds the half stake – 50% in the offshore gas pipeline, 20 % - Italian Eni, 15% - German Wintershall and 15 % - French EDF. Due to the official sources, the project

company South Stream Transport AG is currently involved in engineering, preparation of initial permit documents, environmental impact assessment and construction licenses acquisition.

In November 2011 Gazprom and Srbijagas assigned South Stream's first principle - Banatski Dvor underground gas storage -UGS facility which is one of the largest underground gas storage facilities within Southeastern Europe. Its exploited gas bulk makes up 450 million m<sup>3</sup>, maximum ability to yield - 5 million m<sup>3</sup> per day. Besides, Banatski Dvor has a prospective for more amplification. The UGS facility deepens the safety of Russian gas exports to Serbia, Hungary and Bosnia and Herzegovina.

In December of the same year, all essential and unconditional allowances were donated for unobstructed project implementation for manufacture and operation of the South Stream gas pipeline lying from Russia through the exclusive economic zone of Turkey.

Conformable to Vladimir Putin's concessions, a circumstantial action plan was endorsed in January 2012 to accelerate South Stream project and to impel the gas pipeline construction in December 2012 instead of 2013. Thus the final investment decision on South Stream is planned to be made in November 2012.

### **Developing exchange trade in natural gas**

The use of exchange quotations as pricing benchmarks is a main characteristic of a civilized gas market. From 2006 to 2008 natural gas was traded for a test at free market prices through the electronic trading platform -ETP- of Gazprom Mezhhregiongaz, the Company's trading subsection aiming to develop modern exchange trade technologies compatible to the Russian Federation Government decisions. In 2007 Gazprom was able to sell more than 5 billion cubic meters of natural gas at free market prices and independent gas producers could sell the same amount of gas at free market prices.

In 2008 the bulk of gas approved for ETP transactions was grown to 7.5 billion cubic meters for each party. Due to the results of 2008, the sales volume at the ETP measured 6.1 billion cubic meters of gas totally, with 3.1 billion cubic meters supplied by Gazprom and 3 billion cubic meters by independent producers. Power generating companies purchased 86% of the gas.

The experimental trade has shown its optimism in creating an interaction among market participants including the process of providing exchange traders with online access to Gazprom's GTS. Moreover, it presented the transparency of the pricing benchmarks, secured the gas supply management system, ensured a considerable progress in integration of the electronic trade technologies and promoted the technique regulation for independent producer participation in ETP transactions. When experimental period terminated, gas trade through the ETP was stopped in 2009.

# Gazprom

---

## **Why is Gazprom so important?**

Gazprom is Russia's biggest company and one of the largest companies in the world. Its potential amazes anyone's mind. Gazprom's dominance astonishes due to its size and importance. It owns 25% of the world's natural gas reserves. This domination makes 10 times the size of the largest publicly traded oil and gas company in the world- Exxon Corp. Also, it is as big as Saudi Arabia in terms of hydrocarbon holdings.

In terms of economy, Gazprom brings in 20% of Russia's export income and pays 18% of its tax revenue. Although, the market capitalization of Gazprom is so small and generates a national embarrassment. Due to recent evaluations, the company's market value is \$25 billion, less than that of smaller firms such as Fox Entertainment or AT&T Wireless. The price of Gazprom's stock features 21 cents per barrel of oil reserves, namely, 98% less than the value investors attach to Exxon's reserves. Exxon's stock price interpreted as \$13 per barrel.

In the case of Gazprom, there are several good reasons about how cheap is the company. The perennial asset stripping and the continual opacity resulted in the extremely low valuation of the company. Furthermore, it's a reflection of investors' precariousness about government scopes to liquidate the company or free the firm from costly regulations. In simple words, if Russia cannot put its most valuable company in order, what about the rest of its economy?

Most of Gazprom's problems lie before Putin's regime. Firstly, former managers were permitted by the Kremlin to participate in revelry of stealing. Under Boris Yeltsin's presidency, they transferred ownership of 18.4 billion cubic meters of Russian gas reserves to a shadowy Florida-based company called Itera for probably no speculation. This let Itera to grow from zero to something larger than Chevron Texaco in less than five years.

Second, Russia's heavily regulated system of selling gas to consumers under the market price has encumbered the company's profits. Despite the fact that other areas were under liberalization, natural gas prices have remained constantly stuck under state control like those ones of the Soviet system. German companies pay for gas 89% more than Gazprom sold its gas to domestic customers. This huge surrealistic discount hobbles the Russian economy, and hits Gazprom, which basically subsidizes other Russian companies-including many grossly inefficient ones at a cost of about \$43 billion per annum.

Last but not least, foreigners who were interested in investing in Gazprom were obligated to severe and discriminatory ownership restrictions. The foreign investors intending to buy Gazprom shares had to pay a vast premium, nearly a 100% 'penalty' for not being Russians. Many foreigners investing in Russia have chosen to avoid Gazprom altogether in order not to

pay this discriminatory tax. Only \$1 billion of Gazprom stock is possessed by foreign investors. Meaning that this pales beside the \$15 billion foreign ownership of the Mexican phone company Telmex. This impedes Gazprom's, and Russia's, ability to attract needed capital from abroad.

Before Westerners develop with self complacency about the integrity of their own companies and economies, we have to think this: Gazprom management hold debatable transactions inside the company as a carefully conserved secret with a little help from Westerners. The estimated U.S. accounting firm PricewaterhouseCoopers 'accidentally' omitted to refer any of the asset-stripping units annual reports while working as Gazprom's auditor from 1996 to 2002. Its defaults interpreted as worth of billion dollars' transactions to companies directly occupied by Gazprom management family members.

When Putin entered the Gazprom touch made headlines aiming to refine this ambiguous situation. He fired the asset-stripping CEO, Rem Vyakhirev and replaced him with Alexei Miller, a loyal technocrat who was privileged to recover lost assets and extinguish in transparency.

Putin made some more reforms. He guided the government to liberalize gas prices, and he erected a commission to reform the rules for the new foreign investors so that they could buy Gazprom shares without any restrictions. The share price doubled over the next 12 months in the forecast of all the improvements.

Unfortunately, what started out with the best of purposes ended up with mixed results because Putin couldn't manage the whole procedure. From the standpoint of transparency, it sounds hopeful at first. After two separate investigations into PricewaterhouseCoopers' controlling at Gazprom, Russian government carried forward the new Gazprom CEO held a competitive tender process to select a new inspector for the first time in history. Even though the inspecting firm cleaned up the former management's mess, the board of Gazprom decided weirdly to rehire PricewaterhouseCoopers. This fact made hopes faint.

Almost six months later on the job, Miller declared that the asset recovery exercise began to improve. He had retrieved two of the seven gas fields that were taken from Gazprom. Also, he organized the arrest and prosecution of many past executives who were involved in another asset-stripping intrigue.

But, as soon as Miller announced victory over two major asset recoveries, three more frauds were grew back in Gazprom's gas distribution business. The frauds were estimated to cost Gazprom between \$1 billion and \$2 billion per annum. So, the case of Gazprom started to look like the mythical Hydra creature. As one scam was devastated, two others discovered.

On the issue of domestic subsidy, the news sounds likewise complicated. After long debates, domestic natural gas tariffs launched 37.5%, from \$13.30 to \$18.30 per thousand cubic meters by

the government. Maybe, this looks a decisive step forward. But till how far need prices to be raised? In 2001 the tariff increase restricted the Russian-German discount from 89% to 85%. Thus, six years will need for Russian gas prices in order to achieve parity with the Westerners.

The foreign ownership of Gazprom shares liberalization which announced by the commission was absolutely a disappointment. But commission members instead of extinguishing the discriminatory ownership structure for foreigners, ended up wrangling about how to somehow turn the premium to them. Their fight couldn't end with a result, so the commission decided to send four different proposals to Putin. To mention that, there was as much as \$4.5 billion just sitting there waiting for them, theoretically. Each proposal suggested a different recipient of the foreigners' premium via perplex auction procedures, but none of them endorsed or even supported the rule liberalization for foreign ownership of Gazprom. The problem persists and most foreigners still remain far from Gazprom shares.

To secure his position in the history, Putin needs to guarantee prolong and continual economic growth. The most efficacious boost is augmenting the value and effectiveness of Gazprom and making it a model for Russia's market economy. He should recheck his initial to-do Gazprom list and enforce real reforms. The government owns 38% block of Gazprom stock.

First, he should guide government to use its shareholder votes in the annual meeting to fire PricewaterhouseCoopers and hire a new independent and unbiased instructor to do comprehensive and detailed control of the company and identify where and how theft accomplished. After this, he should establish a special commission to reacquire all lost assets of Gazprom whatever the political connections of the new owners of those assets. Then, he should schedule a three-year program for increasing gas prices to the market level. Finally, he should allow free Gazprom shares' trading regardless of the owners' nationality.

If these theoretical points transformed into practical steps, the value of Gazprom would increase probably between five and ten times more. The value of the 38% government owned stake in Gazprom would also be raised to almost \$100 billion. This could help erase much of Russia's sovereign debt burden and create new channels for both investment and real transparent growth.

One of the most important is that the raising valuation of Gazprom and its transparency would also promote a powerful message; first to other Russian companies afflicted with corporate governance problems and second for those whom diluting stock issues, asset stripping and infringement of shareholder rights have become the process of doing business in Russia during '90s. Thus, domestic and foreign investors would be supported. The conviction that companies, like Russian society in total, have many stakeholders, responsibilities and voices would be encouraged, too.

In one of his speeches to the nation, Putin said, 'Nobody is going to help us. We have to fight for a place under the economic sun on our own'. But this is not entirely true. There are many non-

Russians who are interested in Russia's success. There are many non Russians who are interested in Russian success objectively and other whom Russian success serves their self interests. In any case, both of them want the economic success of Russia and foster the norm that Putin would personally help Russia achieve financial security and economic prosperity for the next generation.

## **Gazprom profile**

In the last years, Gazprom reached an impressive success; operational and financial, which is in accordance with its long-term strategy that consistently brings Gazprom closer to its ultimate objective – to become the strongest company in the world's energy sector. This strategy fits to the current economic environment as only robust, vertically-integrated global companies are able to win the competition in the global energy market. In its operations, Gazprom is driven by the market.

The core product is natural gas. This is the main component of the fuel balance both in Russia and in Europe. 2011 marked the augmentation in gas reserves due to geological exploration 719.8 bcm, which is 40.3 % higher than the production volume. The production amounted to 513.2 bcm of gas, and for the first time ever Gazprom produced stranded Turonian gas at the Yuzhno-Russkoe Field and fed it to the Unified Gas Supply System of Russia.

Gazprom is actively developing the production of both pipeline and liquefied natural gas in order to construct the element of product diversification. Moreover, has introduced the gas-to-liquids fuel technology. These types of fuels were the main drivers of the Company's expansion in the international markets. So, today Gazprom is the only LNG producer in Russia; its LNG plant under the Sakhalin-2 project has been exporting about 10 mln tons of LNG annually for the last two years.

The oil business succeeds too. In 2011, appropriate conditions were set to launch a new scope in the development of the Russian fuel and energy complex; the exploitation of the Arctic shelf. An offshore production platform was deployed at the Prirazlomnoye oil field in the Pechora Sea. Gazprom set another record in the domestic power sector. In the same year, the company built in Russia 1.9 GW of combined heat and power generation units – more than installed by RAO UES of Russia through its history.

To attain the enhancement of exports some fundamental steps needed to be done in the transportation of gas. Nord Stream was assigned – the first gas route to directly connect the Russian and the European gas transportation systems. Another strategic construction, to ensure incessant exports, is South Stream. Also, in 2011, Gazprom became the single owner of Beltransgaz, thus gaining entire control over gas transportation to the Western borders of Belarus. Therefore, the company steadily reduces the zones of transit risks between Russia and Europe. Gazprom's efforts to diversify its markets intend to preserve sustainable long-term sales.

In terms of sales and profit, the Russian gas market is now becoming the main competitor to the exports and the number one market for Gazprom. The company provides gasification of the Russian regions, thus constructing a new gas-consumer base and considerably improving the quality of life, primarily of the rural residents. In 2011, the investments made to gasification reached the high record of over RR 29 bln. However, there is a new record visioned within 2012 – RR 37.66 bln.

In the Eastern Russia, in the new regions of Gazprom's presence, stable grounds for gas supplies are laid down – the company has started to construct the gas transportation infrastructure practically from the very first start.

In the previous year, Gazprom delegated the first gas trunk pipeline in the East of Russia, Sakhalin-Khabarovsk-Vladivostok, which will bring by a large-scale gasification of the region.

In the same year, Gazprom settled the construction of the first offshore gas pipeline for domestic supplies, Dzhubga-Lazarevskoye-Sochi. This pipeline will be the main means of energy supply for the 2014 Winter Olympic Games.

As well as in efforts and investments required, Gazprom projects are objectively incomparable in their scale. The implementation of these projects rests on a high level of financial stability. In 2011, Gazprom showed record-high financial performance: sales revenues, currency earnings, EBITDA and net profit hit the company's historical high.

## MAJOR RESULTS

### GAZPROM GROUP'S RESULTS

<b>OPERATING RESULTS</b>			
	<b>2009</b>	<b>2010</b>	<b>2011</b>
<b>Gas production in Russia</b>			
Gazprom Group's production, bcm	461.5	508.6	513.2
Associated companies' production attributable to Gazprom Group's interest, bcm	7.4	10.5	11.3
<b>Gas Condensate production in Russia</b>			
Gazprom Group's production, mln tons	10.1	11.3	12.1
Associated companies' production attributable to Gazprom Group's interest, mln tons	0.7	0.9	1
<b>Crude oil production in Russia</b>			
Gazprom Group's production, mln tons	31.6	32	32.3
Associated companies' production attributable to Gazprom Group's interest, mln tons	19.1	20.7	20.5
<b>Hydrocarbons refining</b>			
Natural and associated gas refining, bcm	30.4	33.6	33.2
Oil and gas condensate refining, mln tons	44.3	50.2	53.5
<b>Sales of Gas</b>			
Sales of gas in Russia, bcm	262.6	262.1	265.3
Sales of gas in Far Abroad countries, bcm	148.3	148.1	156.6
Sales of gas in FSU countries, bcm	67.7	70.2	81.7

Source: "Gazprom Annual Report 2011"

<b>FINANCIAL RESULTS</b>			
	<b>2009</b>	<b>2010</b>	<b>2011</b>
Sales, RR mln	3,118,462	3,661,699	4,735,822
Profit from sales, RR mln	844,499	1,161,832	1,622,289
Net profit, RR mln	634,119	771,242	1,000,900
Capital expenditures, RR mln	634,976	883,310	1,327,699

Source: “Gazprom Annual Report 2011”

The change referred to the sale sector between 2011 and 2010 reaches 29.3%. Profit from sales 39.6%, Net profit 29.8% and Capital expenditures 50.3%.

#### **OAO GAZPROM’S RESULTS**

<b>FINANCIAL RESULTS</b>			
	<b>2009</b>	<b>2010</b>	<b>2011</b>
Net sales of goods, products, work, and services (net of VAT, excise taxes and other similar payments), RR mln	2,486,941	2,879,390	3,534,341
Profit from sales, RR mln	553,269	821,981	1,188,515
Net profit, RR mln	624,613	364,478	879,602
Net assets, RR mln	5,879,933	6,187,890	7,540,012
Net assets per share, RR	248	261	318
Earnings per share, RR	26.38	15.4	37.16
Dividends per share, RR	2.39	3.85	8.97

Source: Source: “Gazprom Annual Report 2011 - OAO”

The change between 2010 and 2011 is crucial. Net sales of goods, products, work, and services (net of VAT, excise taxes and other similar payments) reaches 22.7%, Profit from sales 4.6%, Net profit 141.3%, Net assets 21.9% , Net assets per share 21.8%, Earnings per share 141.3% and the Dividends per share 133%.

The change in sales, in other income and in income from the participation of Gazprom in other organizations increased the net profit in 2011. Increase of gas sales volumes and prices influenced the increase of sales. A great increase of other incomes was mainly due to increase of issuers' stock quotes, especially quotes of OAO Gazprom Neft, which were driven in reflection by OAO Gazprom the amount of RR 92 bln of income from revaluation of financial investments at the current market value.

<b>CREDIT RATINGS OF OAO GAZPROM</b>		
<b>Rating agency</b>	<b>Long-term credit rating as of 31.12.2011</b>	<b>Date of the last rating change/outlook</b>
Standard & Poor's	«BBB» (outlook: stable)	18.08.2010
Fitch Ratings	«BBB» (outlook: stable)	22.01.2010
Moody's	«Baa1» (outlook: stable)	03.04.2009

Source: "Gazprom annual report 2011"

<b>FINANCIAL RATIOS AND MARKET INDICATORS</b>			
	<b>2009</b>	<b>2010</b>	<b>2011</b>
<b>Return ratios</b>			
Return on equity	10.62%	5.89%	11.67%
Return on assets	8.40%	4.66%	9.24%
<b>Liquidity ratios</b>			
Current liquidity ratio	2.59	2.6	2.54
Quick ratio	2.06	2.18	2.22
<b>Financial stability ratios</b>			
Debt to capital ratio	18.42%	16.04%	16.57%
<b>Market indicators</b>			
P/E ratio (domestic OAO Gazprom's share market)	6.95	12.57	4.61
Average market capitalization, US \$ bln	116.5	131.7	155.2

Source: "Gazprom annual report 2011"

Increase of return ratios in 2011 compared to 2010 was mainly due to an increase of OAO Gazprom's net profit in 2011. More than double increase in earnings per share compared to 2010 was reflected in the P/E ratio that decreased in 2011 up to 4.61.

## Gazprom in 2011

<b>Exploration and Production</b>	
18%	of world's gas reserves
72%	of Russian gas reserves
1.4	gas reserves replacement ratio
15%	of world's gas production
77%	of Russian gas production
6.988	operating gas-producing wells in Russia
2.34	oil and gas condensate reserves replacement ratio
9%	of Russian oil and gas condensate production
6.151	operating oil-producing wells in Russia

Source: "Gazprom Annual Report 2011"

Gazprom becomes the worldwide leader in terms of natural gas reserves, production and the rapidly growing oil segment. The percentage of world's gas reserves is over the ¼ of the total world reserves and the percentage of Russian gas reserves reaches ¾ of the total domestic reserves.

<b>Transportation and Storage</b>	
164.7 thousand km	length of Gazprom's gas trunk pipelines in Russia
683.2 bcm	the volume of natural gas transported through gas transportation system in Russia
66.7 bcm	the aggregate active capacity of 25 underground gas storage facilities in Russia
3.0 bcm	access to active capacity of UGSF in Europe

Source: "Gazprom Annual Report 2011"

Gazprom domains the world's largest gas transportation system. Besides, it is fundamental to mention the developed infrastructure of UGSF in Russia and its access to storage capacities abroad. The performed numbers of the volume of natural gas transported through gas transportation system in Russia

and the aggregate active capacity of 25 underground gas storage facilities in Russia are significant.

<b>Refining</b>	
1st place	among Russian companies in terms of gas refining volumes
52.5 bcm	gas refining capacities
15%	of total oil refining in Russia
77%	oil refining depth
75.4 mln tons	oil and gas condensate refineries capacities

Source: “Gazprom Annual Report 2011”

The numbers show that almost half of the total natural gas is refining in Russia. The company is leading position in oil and gas condensate refining among Russian companies.

<b>Electric power</b>	
17%	of Russian electric power generation
37 GW	installed capacity of 81 power stations in Russia

Source: “Gazprom Annual Report 2011”

Electric power is another sector that make Gazprom leader in the installed capacity and electric power generation in Russia as it holds 17% of the total Russian electric power generation.

<b>Marketing</b>	
Over 70 %	share in the Russian gas market
27%	share in the European gas market
2.3 mln tons	LNG sales (an increase of 24 % compared to 2010)

6%	of total Russian oil export to far abroad
55.4 mln tons	refined products sales (an increase of 6% compared to 2010)
11%	share of oil products sales through a network of gasoline stations in total sales of refined products)

Source: "Gazprom Annual Report 2011"

As for the marketing, Gazprom is the major natural gas supplier to Russian and FSU consumers, the largest natural gas exporter in the European market. It has access to end-consumers at foreign gas markets and growing sales of LNG and is referred as a major player in international oil trade through the increasing refined products sales and growing retail.

## Conclusion

Due to the recent net article (Front Putin Decree Steps up Govt Role in Gazprom Probe/ 11/09/2012/RIA Novosti) ‘President Vladimir Putin has signed a decree enhancing the government’s ability to help major Russian companies under investigation abroad. The decree comes one week after the European Commission launched a probe into three suspected violations of anti-monopoly regulations in Central and Eastern Europe by the gas giant Gazprom Russia’s biggest company.

“First, Gazprom may have divided gas markets by hindering the free flow of gas across Member States. Second, Gazprom may have prevented the diversification of supply of gas. Finally, Gazprom may have imposed unfair prices on its customers by linking the price of gas to oil prices,” the EC mentioned.

Russia's leadership has impeached the probe, which could affect Gazprom’s \$60-billion gas export business in Europe. Prime Minister Dmitry Medvedev vowed to discuss the matter “eye-to-eye” with European antitrust officials. Putin announced that the probe was “unconstructive” and charged that the EU was trying to shift some of the expense of “subsidizing” developing Eastern European economies onto Russia.

Gazprom could face a fine of up to 10% of its annual revenue - about 10 billion Euros - if the suspected violations are substantiated. The decree signed by Putin requires “strategic” companies facing punitive actions abroad to coordinate their response with the Russian government. It also covers the provision of information on company operations and the alteration of foreign contracts and other documents touching upon commercial operations abroad. Shortly after the announcement of the decree, Gazprom spokesman Sergei Kuprianov said that the probe was an effort by the EC to pressure Russia into lowering gas prices.

In a preview of Gazprom’s response to the probe, Kuprianov said the gas giant would no longer offer discounts to its standard gas price without the government’s permission and that the company would accelerate its program to boost gas exports to Asia-Pacific markets. He also complained that the EC had not made any attempt in the past 12 months to open a dialogue with Gazprom concerning unfair competition practices’.

The objective of the energy policy of Russia is to maximize the effective use of natural energy resources and the potential of the energy sector to sustain economic growth, improve the quality of life of the population and promote strengthening of foreign economic positions of the country. The main domestic challenge lies in the necessity for the energy sector to fulfill its vital role in the transition to an innovative path of economic development.

Direct involvement of Gazprom being a distinguished energy resource supplier in power generation and distribution projects will eventually let Russia normalize fuel balance, elaborate and implement effective schemes for balanced consumption of gas, thus preventing from wasteful consumption of blue fuel. It is also important that Gazprom's participation in the power sector will enable Russia to enjoy significant economic benefits owing to the introduction of the most efficient schemes of power supply to production companies.

Gazprom's conversion into a global, vertically integrated energy company with significant energy assets is needed not only by the Company itself, but by the shareholders as well. Strengthening the Company's positions in the power industry will allow Gazprom to increase the attractiveness of its shares in the market and let Russia gain power over years, steadily!

## Bibliography

[http://www.upi.com/Business\\_News/Energy-Resources/2011/04/21/Russia-a-primary-player-in-energy-sector/UPI-52101303383648/](http://www.upi.com/Business_News/Energy-Resources/2011/04/21/Russia-a-primary-player-in-energy-sector/UPI-52101303383648/)

[http://www.upi.com/Business\\_News/Energy-Resources/2011/04/21/Russia-a-primary-player-in-energy-sector/UPI-52101303383648/#ixzz25IHOp1bt](http://www.upi.com/Business_News/Energy-Resources/2011/04/21/Russia-a-primary-player-in-energy-sector/UPI-52101303383648/#ixzz25IHOp1bt)

[http://www.upi.com/Business\\_News/Energy-Resources/2011/04/21/Russia-a-primary-player-in-energy-sector/UPI-52101303383648/#ixzz25IGul8tW](http://www.upi.com/Business_News/Energy-Resources/2011/04/21/Russia-a-primary-player-in-energy-sector/UPI-52101303383648/#ixzz25IGul8tW)

[http://www.upi.com/Business\\_News/Energy-Resources/2011/04/21/Russia-a-primary-player-in-energy-sector/UPI-52101303383648/#ixzz25IGLHfRm](http://www.upi.com/Business_News/Energy-Resources/2011/04/21/Russia-a-primary-player-in-energy-sector/UPI-52101303383648/#ixzz25IGLHfRm)

[http://www.upi.com/Business\\_News/Energy-Resources/2011/04/21/Russia-a-primary-player-in-energy-sector/UPI-52101303383648/#ixzz25IGnBJaM](http://www.upi.com/Business_News/Energy-Resources/2011/04/21/Russia-a-primary-player-in-energy-sector/UPI-52101303383648/#ixzz25IGnBJaM)

<http://www.russianoilgas.ru/>

[hermitagefund.com/newsandmedia/index.php?ELEMENT\\_ID=53](http://hermitagefund.com/newsandmedia/index.php?ELEMENT_ID=53)

<http://www.gazprom.com/investors/reports/2011/>

<http://www.gazprom.com/f/posts/51/402390/financial-report-2011-eng.pdf>

[http://books.google.gr/books?id=GpTrYvLuz\\_YC&pg=PA132&lpg=PA132&dq=economic+analysis+gazprom&source=bl&ots=4nX20zvLUz&sig=LEFehO52x\\_wt8\\_Ts1qRWkh\\_k4&hl=el#v=onepage&q=economic%20analysis%20gazprom&f=false](http://books.google.gr/books?id=GpTrYvLuz_YC&pg=PA132&lpg=PA132&dq=economic+analysis+gazprom&source=bl&ots=4nX20zvLUz&sig=LEFehO52x_wt8_Ts1qRWkh_k4&hl=el#v=onepage&q=economic%20analysis%20gazprom&f=false)

<http://www.gazprom.com/about/marketing/russia/>

<http://eng.gazpromquestions.ru/index.php?id=5>

<http://en.rian.ru/business/20120911/175900461.html>

<http://www.gazprom.com/f/posts/51/402390/annual-report-2011-eng.pdf>

<http://www.ereport.ru/en/stat.php?razdel=share&table=gazprom>

<http://eng.gazpromquestions.ru/?id=5>

<http://www.oecd.org/trade/non-tariffmeasures/43955106.pdf>

<http://www.eia.gov/tools/faqs/faq.cfm?id=48&t=8>

[http://www.energystrategy.ru/projects/docs/ES-2030\\_%28Eng%29.pdf](http://www.energystrategy.ru/projects/docs/ES-2030_%28Eng%29.pdf)

