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EGF Gazprom Monitor

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A Snapshot Of Key Developments In The External Relations Of The Russian Gas Sector [1]

Key points:

- *Gazprom has been offered the chance to purchase a further 50 percent stake in Beltransgas, although Russian officials and Gazprom representatives have questioned the benefits of the proposed acquisition*
- *In the first quarter of 2011, Gazprom set a new record for gas exports to Europe. Profits from first quarter 2011 sales were equal to almost 80 percent of net profits for the whole of 2010, according to Gazprom management and bearing in mind Russian Accounting Standards. However, from the beginning of next quarter the rate of growth of exports will probably fall. Although gas prices are set to rise, Europeans will have replenished their fuel stocks by then*
- *The Lithuanian government has signed a Memorandum of Understanding with America's Cheniere Energy, which raises the possibility of Lithuania importing up to 40 percent of its gas from the US once the Klaipeda LNG terminal is completed in 2014*
- *Following the increase in Nabucco construction cost estimates, the project participants have decided to delay their decision on investment until 2012. Gazprom's South Stream project, due to come on-stream in 2015, will thus receive further momentum.*
- *The Russian Ministry of Finance has proposed a hike in the mineral extraction tax, which would have a significant impact on Gazprom's business. According to Alexei Kudrin, Russian Finance Minister, the gas sector does not pay enough taxes (in contrast to the oil sector)*
- *Despite Gazprom management's recommendation to pay dividend on the basis of 2.7 Roubles per share, the Board of Directors has suggested increasing it to 3.85 Roubles per share, which would be a record for the company. A final decision is due to be taken on June 30 during the annual general meeting of shareholders.*

[1] The EGF Gazprom Monitor is completely based on Russian sources and is translated into English by Jack Sharples, PhD candidate at the University of Glasgow, Scotland, and EGF Researcher on Russian external energy policy

EUROPEAN GAS MARKETS

Belarus gas assets up for grabs, yet again

The President of Belarus, Alexander Lukashenko, seems to be optimistic about the possibility of obtaining Russian credits to rescue the Belarusian economy. On May 17, he stated that Moscow was ready to lend Minsk $6 billion in 2011. However, the Kremlin responded by suggesting that it will only lend $1 billion and that even this amount will only be possible in combination with the sale of a number of Belarusian assets, notably a 50 percent stake in Beltransgas. Gazprom already holds a 50 percent stake in the company.

Negotiations regarding the sale of the remaining 50 percent share in Beltransgas began a year ago, when Lukashenko proposed lowering the price of Russian gas for Belarus to the level of Russian domestic prices, which would have entailed halving the price Belarus pays for Russian gas imports. However, this proposal found no support among Kremlin officials or Gazprom representatives. Indeed, Russian Deputy Prime Minister responsible for energy, Igor Sechin, has stated that Gazprom 'overpaid' for its $2.5 billion share in Beltransgas, and that the purchase of further shares makes no economic sense.

So far, there has been no official response from Gazprom. Although the $2.5 billion needed to purchase the remaining 50 percent stake in Beltransgas does not represent a large amount of money for Gazprom, the acquisition may be considered as having greater geopolitical than economic value. If it does take place, Gazprom's acquisition of the remaining stake in Beltransgas will be driven not by the former's Board of Directors, but by other actors with different interests. Gazprom knows well that the purchase of the remaining share in Beltransgas will be accompanied by such a range of conditions — including lowering of gas prices — that it need not expect any benefits such as increased security for transit across Belarus or increased revenues.

Investment into gas storage a key part of Gazprom's strategy

Over the next four years, Gazprom plans to double its underground gas storage capacity to 4.9 bcm (billion cubic metres), according to a statement by the Head of Gazprom Export, Alexander Medvedev, at the recent European Gas Storage Conference (EGSC)..

Accordingly, on May 19, Gazprom and Verbundnetz Gas AG signed an agreement to build the 'Katarina' Underground Gas Storage Facility (UGSF) in Germany with a capacity of 629 mcm (million cubic metres). In Serbia, Gazprom plans to put the 'Banatsky Dvor' UGSF (capacity: 450 mcm) into operation by the end of the year. On May 18, the Dutch Government granted the licence for the construction of the 4.1 bcm capacity 'Bergermeer' UGSF, in which Gazprom will receive 1.9 bcm of storage capacity. Gazprom is currently searching for, and conducting feasibility studies for, the construction of UGSFs in several countries, including the Czech Republic, France, Belgium, Romania, Slovakia, and the UK.

According to Gazprom, between 2006 and 2010, the company increased its storage capacity from 1.4 bcm to 2.5 bcm and its daily output from gas storage from 18.2 mcm to 30 mcm.

The plans for the rapid increase in gas storage capacity are directly connected to Gazprom's long-term forecasts, which it uses to formulate its long-term strategy. At the EGSC, Medvedev announced that Gazprom will supply Europe with 155 bcm of gas in 2011, as opposed to the earlier forecasted volume of 151 bcm. In comparison, Gazprom supplied Europe with 139 bcm in 2010.

Gazprom's rising gas exports

In the first quarter of 2011, Gazprom exported 31 percent more gas than during the same period in 2010. This was mainly the result of increased purchases by Italy, Turkey and the UK, while 11 bcm were delivered to Naftogaz Ukraine, for the repayment of its gas debt to the trader RosUkrEnergo. During the first quarter of 2011, Gazprom earned 295.1 billion Roubles, which was equal to 79.9 percent of its post-tax net operating profit for the whole of 2010. Such growth has led to forecasts that, according to International Financial Reporting Standards, Gazprom's net profit for 2011 will be a record-breaking 1.5 trillion Roubles.

The growth in Russian gas exports is also linked to the simultaneous rise in oil prices, to which gas prices are linked by an approximately 9-month time lag. Indeed, Gazprom boss Alexei Miller has already suggested that European gas prices could reach $500 per 1000bcm by the end of the year. Given the 'take-or-pay' clauses in Gazprom's contracts with its European customers, it seems that many of these European customers prefer to increase their purchases now, before the expected price hike. Hence the growth in Gazprom's exports, and the subsequent predicted slowdown, or even reversal, of this growth in the third and fourth quarters of 2011.

Such a trend was observed in 2008, when Gazprom's European exports grew by 37 percent in the first quarter and by 15 percent in the second quarter, during a time of high oil prices, only to decrease thereafter. Gazprom should expect a similar turn of events in 2011, resulting in an overall annual export increase of 5-8 percent (i.e. to 150 bcm), as expected earlier, rather than Medvedev's announced 155 bcm.

Lithuanian hopes raised by new agreement with US gas supplier

Negotiations between Gazprom and the Lithuanian government over gas prices, having dragged on for almost a year, have taken an unexpected turn. The Lithuanian state company Klaipedos Nafta has signed a Memorandum of Understanding (MoU) with America's Cheniere Energy on the delivery of LNG to Lithuania.

Gazprom currently enjoys a monopoly position on the Lithuanian gas market, and the MoU with Cheniere represents an attempt by Lithuania to diversify its gas imports and thus reduce its dependency on the Russian gas major.

However, LNG imports cannot begin before the completion of Lithuania's LNG port at Klaipeda, scheduled for 2014. Construction of the port is slated to begin this year at a cost of 300 million Euros.

The project will allow Lithuania to import 40 percent of its gas needs via LNG, meaning that it will probably remain dependent on Gazprom for the remaining 60 percent. Moreover, by 2014 it is likely that the global LNG surplus will have disappeared, leading to a levelling off of prices between LNG deliveries and the gas supplied by Gazprom on long-term contracts.

Nabucco's setback is South Stream's gain

At the beginning of May it was announced that the cost of constructing the Nabucco pipeline has risen from 7.9 billion Euros to 12-15 billion Euros. Such a cost hike can be explained by the fact that the latest estimates include the cost of constructing a pipeline from Turkey to the neighbouring gas-supplier states.

The estimate of 7.9 billion Euros was made in back in 2005 and re-appraisal is therefore quite logical. However, the participant countries are reluctant to support the project on the basis of the latest figures, leading them to delay their investment decision until 2012.

Nabucco's lack of a confirmed resource base and the project's difficulty in attracting investment have played into Gazprom's hands and is working in favour of the South Stream project. According to Gazprom, South Stream will be launched in 2015, and this summer the European Commission will be presented with a business plan for the project.

Given that the routes of South Stream and Nabucco are, to a good degree, similar, and taking into account that the capacity of the Russian project is set to be twice that of Nabucco (60 bcm per annum vs. 30 bcm per annum), the competition between the projects is mainly based on the time of their implementation. When the first project is completed, the need for the second will be practically obliterated. It therefore appears as if South Stream's hopes of success have received a definite boost by the above mentioned developments.

DOMESTIC MARKETS

Russian Finance Minister to impose new tax burden on Russia's gas monopoly

The Russian Mineral Extraction Tax for gas remained unchanged from 2006 to 2010, being fixed at 147 Roubles per 1000 cubic metres of gas. From 2011, this will increase by 61 percent to 237 Roubles per 1000 cubic metres. From 2012, this tax was supposed to be indexed-linked to the rate of inflation, but the Ministry of Finance has decided to steeply hike the rate from the planned 251 Roubles to 529 Roubles per 1000 cubic metres.

In order to prevent independent gas producers from being affected, the Ministry has proposed applying the radical tax increases only to those companies which manage their own gas pipelines, while for the others the taxes will be index-linked to the rate of inflation. In Russia, the monopoly Gazprom decides which companies gain access to its pipelines, and which do not. If the decision is taken to raise the Mineral Extraction Tax to 529 Roubles per 1000 cubic metres, Gazprom's tax payments will more than double from 130 billion Roubles to 280 billion Roubles

Alexei Kudrin, the Russian Finance Minister, has stated on several occasions that Gazprom's tax burden is 2-2.5 times lower than those of oil companies and that the gas sector in general does not pay enough in taxes.

Gazprom shareholders to enjoy higher dividend payout

Gazprom's general shareholders meeting will take place on June 30, during which the question of dividends will be resolved. Despite the recommendations of the Management Board, the Board of Directors has approved an increase in dividend payments of 61 percent in comparison with 2010, meaning payouts of 3.85 Roubles per share. If the decision of the Board of Directors is supported by the Council of Shareholders, the payment of dividends for 2010 will be 91.1 billion Roubles, or 25 percent of post-tax net profit, bearing in mind Russian Accounting Standards – a new record for Gazprom.

End of the EGF document

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