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***“Tightening grip” of Gazprom: a reality check
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A great deal of hyperbole permeates the trade and general press when it comes to Gazprom’s outbound investments. A more sober look at Gazprom activities abroad produces another picture – the advent of Russian foreign direct investment in activities considered to be core, strategic businesses has taken at least a decade just to be launched.

Gazprom has tried to engage in exploration and production projects abroad since the mid-1990’s, yet there is only one major project currently in the production phase – a 30 percent share in South Pars 2 and 3 in Iran initiated in 2001 (Shakhpakhty field in Uzbekistan, another producing venture abroad, holds about 9 bcm of reserves and is insignificant in terms of production volumes - less than 0.5 bcm annually). The geography of Gazprom’s international exploration and production (E&P) and infrastructure projects is diverse – India, Vietnam, Kazakhstan, Venezuela, Libya, Kyrgyzstan, Nigeria, Canada and even Alaska. It is worth noting that the majority of international ventures were started very recently (2003-2006), they are moving slowly and future prospects are obscure. For example, a petroleum service agreement (PSA) venture in Vietnam was established in 2000, while the first exploratory well test occurred only in late 2007, likely just in time to fulfill the exploration terms.

Talks on E&P opportunities in Egypt, Pakistan, Saudi Arabia and Algeria, which Gazprom was also eyeing for a while, turned out to be unsuccessful. The failure in Algeria was especially bitter for Gazprom, since it sees that country as a strategic partner for European natural gas supplies. (However, as noted below, an alternative strategy appears to be underway in Nigeria associated with the TransSahara pipeline venture.) Gazprom finally achieved an agreement in Bolivia, signed in September 2008, covering exploration of the Azero block with maximum production capacity of 9.5 bcm annually and 24.5 percent Gazprom participation. The Bolivian agreement coincided with a memorandum of understanding (MoU) for Delta Caribe Oriental in Venezuela, which stipulates a 30 percent Gazprom share in the exploration and reserve certification processes phase and 15 percent in the production phase primarily dedicated to LNG (6.6 bcm annually). The LNG operation is planned to be underway by 2016. It is quite possible that Gazprom will accelerate its efforts to obtain exploration licenses and launch exploration activities in Africa and Latin America. All in all, under a business-as-usual scenario and given the lead time of 7-8 years for Gazprom’s E&P operations as well as the scope of projects abroad, the company’s overseas production should not exceed 3-5 percent of



global exports by 2020.¹ The lion's share of that production will be from resources that are "stranded" with respect to domestic or regional consumption.

International transportation projects pursued by Gazprom would seem to offer more grounds for worries, especially for observers in the European Union. The Nabucco pipeline saga, accelerated by recent agreements on upgrades of existing capacity and construction of new pipeline capacity from the Caspian region to Russia, is probably the best example of a politically-driven energy mega project that was aimed to reduce European dependence on Gazprom. Nabucco is supposed to deliver about 31 bcm of Caspian natural gas to Central Europe via Turkey and in fact would duplicate existing routes via Russia. Not only would the Nabucco Partners shippers compete for supply with Gazprom, China National Petroleum Corporation (CNPC) and quite possibly India's Oil and Natural Gas Corporation (ONGC). Nabucco would bring limited value to producers since Gazprom recently arranged long-term contracts with the Central Asian producers based on net-back price formulas estimated to be pretty close to European benchmarks. The main potential positive outcome of the Nabucco project is to bring additional supply from Iran to European markets, but the chances of that actually occurring are currently pretty slim for political reasons.

Additional routes that are expected to partially replace transit flows through Belarus and Ukraine, namely South Stream in South-Eastern Europe and Nord Stream in the Baltics, are said to be designed to protect Gazprom from unauthorized withdrawal of gas by these transit countries and delayed payments. A mantra that Gazprom would dangerously increase its share of European supply is hardly a forcible argument. The most recent Russian government forecast² is that Russian natural gas exports will be in the range of 280-330 bcm by 2020. This outlook includes Sakhalin and Shtockman LNG export commitments as well as pipeline deliveries to Asia, China in particular, all of which would amount to about 60 bcm. At the same time, Russia exported on average 201.3 bcm in 2005-2007, including 159.3 bcm to non-Former Soviet Union (FSU) European countries. This leaves the EU with 20-70 bcm a year of additional supply from Russia. The latter figure would definitely require additional pipeline transportation capacity. Currently, Nord Stream is meeting significant resistance from EU members despite the fact that European demand is predicted to increase by about 20 percent by 2020³ (Eurogas 2008), while supply would suffer a deceit of 152 bcm. The same study projects an increase in import dependence on suppliers from outside of Europe, with total share expected to grow from 41 percent in 2005 to 68 percent in 2020. This means that in the best possible case for Gazprom its share in EU non-FSU gas imports would be reduced to 49 percent from the current 61 percent⁴. The only plausible options for European customers to close this gap are to increase pipeline supply from North Africa or to import new gas supplies as LNG, or to sign new contracts with Gazprom and let it provide the infrastructure.

With all other Gazprom transportation projects in the works, a reasonable question to ask is whether there would be a significant flexibility in supply options and whether the company would be able to effectively take advantage of that flexibility. Right now it is realistic to talk only about Sakhalin and Shtokman LNG, which target Pacific and Atlantic markets,

¹ Additional considerations stem, of course, from financial and economic dislocation and declines in commodity prices.

² The Concept of Long-Term Socio-Economic Development of the Russian Federation. Ministry for Economic Development of the Russian Federation. August, 2008 (in Russian).

³ Natural Gas Demand and Supply. Long Term Outlook to 2030. EuroGas, 2007.

⁴ Calculations are partially based on EuroStat data.

respectively. Sakhalin LNG capacity is already fully contracted with about 60 percent allocated to Japanese buyers, while the rest was promised to South Korean and North American customers. In the Atlantic basin, natural target markets for Shtokman LNG are the Iberian Peninsula in Europe, virtually disconnected from the pan-European natural gas network, and North American LNG regasification terminals on the East Coast. Gazprom affiliate Gazprom Marketing & Trading (GMT) has already signed a preliminary MoU with Spain's Gas Natural for LNG deliveries, expected to be executed at first on a swap basis similar to previous deliveries to the US, Japan and Korea. As far as the North American market is concerned, Gazprom has already secured sales to the Rabaska LNG terminal in Canada, yet it is reasonable to be cautious regarding prospects for this and other potential deals. The North American market is traditionally less lucrative for LNG suppliers as compared to European and Asian ones. There is also uncertainty about the supply-demand situation in the mid-term for United States and Canada. Unconventional plays in the region have proven to be economically feasible, if sensitive to lower price decks, and their share of supply is growing. Production of marketed natural gas in the US is currently at its highest point in the past 23 years.⁵ Changing supply-demand conditions are probably the main reason for developers of another regasification terminal in Canada, Kitimat LNG, to announce plans to reverse that project and build a liquefaction facility targeting Asian markets.

Likewise, plans for pipelines to China and Israel would hardly add flexibility to Gazprom's supply scheme, since the former would most likely tap production from West Siberian fields (most likely Kovikta) while the latter would carry insignificant volumes. The most promising direction for Gazprom is participation in pipeline projects from African countries to European markets, such as the huge TransSahara project⁶, or pipelines in the works from Algeria and Libya; although the history of the latter indicates reluctance of suppliers to give Gazprom equity in the projects. At best, Gazprom may gain an insignificant, if any, share in those ventures (up to 10-15 percent) and some kind of coordination of supplies, especially in a low-price natural gas market scenario. Other value-adding ventures, mostly in Europe (such as LNG, pipeline and storage supply swap deals, penetration of industrial and consumer retail markets, participation in electric generation and risk management instruments even to the extent of weather futures), all of which are managed by GMT, are of dubious success even given the relatively short history of the effort (GMT was established in 1999). GMT's net profit amounted to \$65 million in 2007 with deliveries of only 4.5 bcm of Gazprom's natural gas - a drop in the bucket of Gazprom's consolidated results. The penetration of consumer markets will continue, with possible expansion to regions other than EU and FSU. However, the development process is too tedious and time-consuming for these ventures to make a substantive difference in mid-run operating and financial performance.

Gazprom faces exactly the same challenges abroad as international oil companies do. In Iran, Gazprom confronts political risks and pressure. Since the company has interest and operations in the US, any Congressional action that restricts significant investment in Iranian energy sector (such as the Iran-Libya Sanctions Act, passed in 1996 and the Iran Sanctions Enabling Act, passed by the US House of Representatives in 2007), is potentially harmful for Gazprom and is one of the reasons holding back investment. Gazprom's status

⁵ Based on comparison of production volumes for the first six months on a year-to-year basis. Source: Energy Information Administration.

⁶ Gazprom has recently signed a MoU with Nigerian NNPC on the joint development of the pipeline. Reserves are reportedly committed to the project. NNPC has a separate MoU with Algeria's Sonatrach as TransSahara would link with Algeria's Mediterranean exports. Nigeria sees TransSahara as key for development of Nigeria's vital east-west gas pipeline capacity and development of northern and overall domestic natural gas internal market goals.

as a Russian sovereign company would not exempt it from above ground risks in Nigeria, Algeria, Pakistan and Libya; a Gazprom representative spent several months in jail in Libya on espionage charges. Nor would the company be exempt from risks of “resource nationalism” in Kazakhstan, Venezuela and Bolivia.