

Energy for the Planet

Statement by Alexei Miller, Chief Executive of Gazprom, at the 23rd International Gas Conference, Amsterdam, 6th June 2006

Ladies and Gentlemen,

I am delighted to have the opportunity to greet the participants of such an authoritative forum. The Gas Conference has always been the place where, traditionally speaking, the major issues facing the development of our industry are discussed, and I am confident that this 23rd IGC will prove no exception in that respect.

How are we to provide the energy to fuel the sustainable development of the world's economy? How do we achieve regional and global energy security? How do we use our existing resources in the most effective way? These are the key issues on the agenda for those who are buying, and those who are selling gas.

Gazprom is developing successfully as a vertically integrated global energy company, and a few words about what the company is doing will demonstrate our solutions to the energy problems facing the world today.

Gazprom today

Gazprom today is flourishing, and developing in a very dynamic way. This holds true for all aspects of the company's activities.

In 2005, we turned our backs resolutely on the tendency to sit back and live off our reserves, recording the largest yearly increment in reserves since 1993 – approximately 583 billion cubic meters – which was significantly more than our yearly output figures. This means that the growth in Gazprom's reserves for 2005 alone was enough to supply gas to a country like Germany for the whole of 15 years!

Gazprom's resource base today is more than 29 trillion cubic meters of proven natural gas reserves, and more than 1.2 billion tonnes of gas condensate. Acquiring Sibneft increased our oil reserves to 1.3 billion tonnes – a tangible resource upon which to build Gazprom's development strategy.

The further development of this mineral resource base remains one of the highest priorities in Gazprom's activity. Under the Programme for the Development of the Mineral Resource Base in the Gas Industry to 2030, the annual average inventory of gas reserves should be between 700 and 800 billion tonnes per annum. Implementing the Programme will provide for a growth in gas reserves of 23.5 trillion cubic meters and in liquid hydrocarbons of 3.4 billion tonnes.

This puts Gazprom in a very advantageous position compared with other companies that do not have the capability to increase their physical reserves in this way. The problem of dwindling reserves – a problem facing the gas business almost everywhere in the world - simply does not exist for Gazprom. While so many other companies have to face the issue of “*Where* are we to get our gas?”, for Gazprom the question has always been “*When* is it best to get our gas?”

The other problem that worries those who buy gas is the issue of the speed at which producers can step up their output. Gazprom has found the answer. In 2005 we produced 548 billion cubic meters, which is once again an increase in production as compared with the figures for the year before, and 37 billion cubic meters more than we produced in 2001. Over five years we have increased our annual gas output by an amount that is comparable to the overall consumption of a country like Argentina.

The main increase comes from expanding gas production at the En-Yakhinskoye, Eti-Purovskoye and Pestsovoye fields, and the Aneryakhinskoye zone in the Yamburg field as well as bringing output from the Zapolyarnoye field up to full capacity.

As things stand today, our production capacity is far greater than the output of gas we actually achieve. The latter figure relates to how much the transport networks can carry, how much gas is taken from underground storage facilities, and the vagaries of the weather. Our point of departure is the requirements of the market, and we produce however much gas the market requires of us. If there are any limitations on the amount produced, they are to do with the capacity of the market and the amount of demand from customers who can afford to pay a realistic price, rather than with our production capacity. Even today, Gazprom has significant untapped gas production potential, and we shall be exploiting that potential in line with our business interests and with the way relations develop with our partners and our customers.

Today, Gazprom has decided upon the order in which it intends to develop its deposits and a timetable in which to do it. Any contracts which have already been signed will be honoured 100%, using the gas to be produced under this timetable, and we already know exactly in which order, when and which fields we intend to develop right up to 2015 and beyond.

The levels of output planned between now and the year 2010 will be achieved at existing and newly-developed fields in the Nadym-Pur-Tazov region: the Yuzhno-Russkoye field, the Lower Cretaceous deposits in the Zapolyarnoye and Pestsovoye fields, and the Achimov deposits in the Urengoy field. The economic sense of tackling the fields in this particular region is because of their proximity to the existing gas transport infrastructure.

After 2010, our forecast volumes of gas production will be achieved through offshore development in the Arctic seas, in the estuaries of the Ob and the Tazov in the Karsk Sea, in Eastern Siberia, in the Far East of Russia and on the Yamal Peninsula.

The Yamal Peninsula is a strategic region for the company, in terms of gas production. We have opened up 26 fields within the peninsula alone, with known reserves of 10.4 trillion cubic meters of gas. Overall reserves amount to an unprecedented figure of 50 billion cubic meters.

Gazprom makes full use of all the advantages of vertical integration. We implement a unified development strategy across the whole range of gas business activities, from exploration and production, through distribution, to marketing the gas. Having one central decision-making apparatus allows Gazprom to deploy its financial, material and technical resources flexibly, enabling the company to implement projects on even the very largest scale. Thanks to the company's vertical integration, it can balance the development of its production and transport capabilities depending on the priorities dictated by the needs of the business.

Over the last few years Gazprom has tripled its capital investments, with an overall yearly figure of more than 10 – 11 billion US dollars. Today, it is transport that takes precedence in our investment programme. Getting the gas to the consumers is the first priority, and apart from everything else, transportation is a much more capital-intensive process than actual production. For this reason Gazprom's current investment in the transport sector is approximately twice what we are investing in production.

One of the company's most important development strategies is to extend and increase the reliability of its gas transportation system. The Unified System for Gas Supply in Russia (USGS) is owned and operated by Gazprom. The Russian gas transportation system is distinguished by its centralised management, the size of its ramified structure and the existence of alternative routes for transporting the gas. The USGS allows for a uniquely flexible approach to gas supply, with a sound margin of reliability, to provide a stable supply of gas from well to end-user even during seasonal peak usage.

Another important task facing Gazprom is the further development of underground storage facilities both within and outside of Russia itself, located close to its export markets, which ensures security of supplies to the customers.

The final link in the chain of Gazprom's vertical integration is its system for marketing the gas. At the moment, there are three facets to this system: marketing gas in the European market, in the former USSR, and in Russia's own domestic market.

Russian gas has been piped into Europe now for more than thirty years. Gazprom's export strategy is based on having a single export channel and a system of long-term contracts. The gas goes to 21 Central and Western European countries, mostly under long-term contracts of up to 25 years. In most cases, the export is governed by an intergovernmental agreement.

Export volumes are growing steadily. In 2005, Gazprom sold 156 billion cubic meters of gas in the countries of Europe, accounting for about a quarter of all imports into those countries. Under contracts already signed, over the next 10 – 15 years Gazprom will export approximately 2.5 trillion cubic meters of gas.

The laws of commercial logic are becoming a necessity not only for European consumers, but also for the countries of the former USSR. Gazprom respects the trend towards economic independence, and we are moving towards principles for cooperation that are in tune with the status of those countries in the world of today.

Of course, a change to market-based pricing is a challenging business. Up until very recently, Gazprom was to all intents and purposes subsidising several of the states of the former USSR, in which we do not always see a readiness to react appropriately when unavoidable difficulties arise.

What happened to the gas transiting through Ukraine is a good example of such difficulties. We supply gas to Ukraine as well as we transit our gas deliveries to Western Europe. In the end of 2005 we had quite challenging situation concerning negotiations over gas prices for Ukrainian customers. In the end we overcame those difficulties. But the non-authorized siphoning of gas from Ukrainian part is the reason of the conflict situation.

The most important result for European energy security of the Ukrainian *debacle* was the fact that now there are separate contracts for the supply of gas to Ukraine and for the transit of Russian gas through Ukrainian territory on its way to Europe. Before, there was a single contract covering both transit and gas deliveries, which allowed Ukraine in practice to blackmail both Russia and Europe on the issue of gas supply. Now, however, the terms for deliveries to Europe have been uncoupled from the terms for gas deliveries to Ukraine.

Gazprom sells the majority of the gas it produces (about two thirds) in the Russian domestic market. We have now achieved a stable supply of gas to Russian consumers and created the kind of conditions that will allow us to tackle the long-standing problem of developing a market inside the country.

Gazprom is continuing to prepare for the liberalisation of the gas market for business customers. By using both long-term contracts and the technology developed by commodity exchanges, it will become possible in the supply of gas to industrial customers to remove the existing disproportion between the price of gas and that of alternative types of fuels.

And to conclude this description of Gazprom today, I would just add that we have already become a major multi-product energy company. Acquiring Sibneft doubled our oil reserves and tripled out potential output of liquid hydrocarbons. Gazprom is continuing to develop into petrochemicals,

including synthetic liquid fuels production. We regard bringing high added-value production processes closer to the resource base as a strategically-important aspect of our plans for development.

We have acquired assets in the electricity industry – 10% of RAO UES and a blocking package of shares in RAO UES's most important subsidiary, Mosenergo. We are already receiving dividends from these investments, and are planning to increase our presence in this sector of the energy business. Electricity is a part of Gazprom's core business, permitting us to achieve a tangible degree of synergy. It should be noted that Gazprom is considering participating not only in gas-fuelled generation projects, but in coal-fired ones as well. This will free up significant volumes of gas that at the moment are being used inefficiently to generate electricity in Russia.

Our asset-structure, integrationally-organised business and list of shareholders already allow Gazprom to combine the advantages of the transnational energy majors with the positive aspects of being a national, State-owned company. Gazprom can provide the whole cycle, from production through to sales, using a large variety of types of partnerships and ways of financing projects. Investor confidence in Gazprom's prospects, strengthened by the long-awaited decision to liberalise the market in the company's shares, will provide a boost to its capitalisation. Gazprom's market capitalisation has increased by more than 25 times over the last few years! We now confidently take our rightful place in the top few companies in world rankings for capital growth.

Trends in the sector, and the role of Gazprom

The current state of the international market in hydrocarbons is defined by the growth of consumption of primary energy resources both in traditional, and in "new" centres of consumption (like China, India and Latin America). Developing countries are now taking over from developed ones as the leading consumers of energy, and it is they who define the changing patterns of world energy consumption, with new inter-regional flows of energy resources. In the world as a whole there is an increase in demand, energy prices are growing, and global competition for resources is becoming more intense, competition that includes more and more companies from countries without enough hydrocarbon reserves to guarantee economic growth.

The competition for access to energy resources between the three largest gas markets – Europe, Asia-Pacific and North America – will continue to grow.

This is good news for Gazprom. Our main product – natural gas – is needed in both East and West, while modern technology has created a market for it in North America as well.

Asia

At the moment, natural gas accounts for only 10% of the energy balance in the countries of the Asia-Pacific region. It is, however, here that the highest growth rates for gas demand are forecast over the next 15 years. The projected growth rate in this region is twice as high as in Europe.

Our partners in Asia are making great efforts to develop their business links with Gazprom, and are showing a willingness to build their plans on supplies of gas from Russia. We are already at the stage of commercial negotiations to supply gas to potentially the largest Asian market – China – and we plan to conclude an agreement by the end of the current year.

Two routes to supply gas to China have been mapped out, the Western and the Eastern. Deliveries are to start in 2011, with annual volumes of 68 billion cubic meters. Gazprom is already engaged on the financial feasibility study for investment in this project. The resource base for supply via the Western route will be the Western Siberian fields, which are close to the existing gas infrastructure, a factor that will allow deliveries to start as soon as possible. One issue of primary importance for us is the fact that China is prepared to buy Russian gas at a price based on a basket of prices for oil products.

America

While the Asian market, as we have already noted, is the most dynamic and therefore of interest to Gazprom, North America is somewhat different. Firstly, it is the largest market of all, and secondly, (in order, not in importance) its prices are the highest. But apart from these considerations, a glance at the globe is enough to demonstrate the advantages of the Russian resource base's geographical location for projects to produce LNG for the USA and Canada, when compared with the fields in the Middle East.

During the first stage of a Gazprom presence in the American market, we plan to make spot sales of non-Russian liquefied natural gas, in which swap arrangements with our pipeline gas would be a part of the picture. The process is already under way. In September 2005 we delivered our first shipment of LNG to the American market. The next stage will be to sell LNG produced by ourselves on the world market, which could realistically happen after the year 2010.

Today, Gazprom is talking to the leading players in the world's LNG market about the possibility of concluding an agreement to cooperate more closely on the production and marketing of this particular product. We view the project for a LNG plant on the Baltic as a way of gaining the necessary experience for us to be able to supply large quantities of LNG from the Stockman field with maximum efficiency.

Gazprom uses all available modern technology to increase efficiency and gain entry to new markets that were technologically inaccessible to us before. When deciding our policy on LNG, however, we are planning not only for the optimistic assumptions so prevalent in the analysts' reports today, but also for a starker reality.

Current experience in implementing LNG projects has shown that anyone who takes up this promising product must be prepared for anything. Today, we are much more aware of the technical and engineering risks inherent in LNG projects. Many projects have to face exponentially escalating budgets and construction that falls further and further behind the timetable. Analysis shows that current technologies are not yet super-reliable. Whatever the causes, when it comes to technical and engineering risks, the risks with LNG are of an order of magnitude higher than those associated with pipeline gas from the system.

There is one thing about all this that we find especially troubling. We see the subject of LNG being used as another argument on the side of those who would abandon technologies and systems that have stood the test of time over the decades that they have been transporting gas. We are sceptical about any efforts to present LNG as the panacea for enhancing the energy security of gas consumers.

Transporting gas in the form of LNG by sea is profitable only on long distances, another factor which we are forced to take into account when discussing problems of gas supply to Europe.

Apart from other considerations, LNG is more expensive and therefore raises the pricing stakes for traditional supply of pipeline gas as well.

And, finally, LNG production projects and the regasification terminals at the other end will still always remain heavily dependent on the volumes of natural gas available under contract.

We are convinced that the best-positioned companies in the market are, and always will be, those which are capable of providing a flexible mix of traditional technologies for transporting and storing gas with new ones.

Long-term contracts are still the foundation of the gas business for pipeline deliveries. They play, and will continue to play, a decisive role on the gas market. One of the unique things about the gas business is the fact that no one produces gas until they have sold it; if output is not covered by contracts for that output, that output will disappear. Today it is only long-term contracts that can guarantee the financing for the implementation of capital-intensive and long-term gas production and transport projects.

Europe

When formulating our plans for Europe we take into account the projected growth in demand for gas over the next couple of decades. For Gazprom, Europe is a market with existing demand and projected growth in consumption. We already have an infrastructure and partnerships in this part of the world, and most of our transport capacity is for export to Europe. Gazprom is an active participant in

the process of liberalising European markets and is developing new ways of trading in Europe, but we do not expect either rapid development of LNG or more active spot trading to squeeze out gas bought under long-term contracts. What they provide is the most important thing that a gas market needs: stable supplies and predictable prices.

Proximity of Russia and European consumers is a fact. Thus, there is no other cheaper and economically efficient way of transportation for gas than pipelines.

While on the subject of energy security, I feel that the following point ought to be stressed. The management of Gazprom considers that there can be no security for gas consumers without security for gas producers. No formula for energy security can be viable unless it provides an incentive to produce that energy. The producer of gas, like the consumer, needs some confidence in the future, especially when planning for the long term.

We consider that it is not protectionist barriers, but cooperation and international integration that best defend national and European interests when it comes to gas supply. Gazprom has chosen to develop projects structured on an exchange of assets, like the project to develop the Yuzhno-Russkoye field with German companies. The project covers the whole cycle from production to end-user and is becoming a joint business, more far-reaching than the usual relationship between buyer and seller. This is a qualitatively new level of cooperation with our European partners.

Much has been said of late about the need to diversify supplies of gas to Europe. Europe is the major consumer of Gazprom's product. We too consider that diversification is the way to guarantee energy security – but what kind of diversification?

For Gazprom, diversification means being free of the risk of instability in transit regions and the ability to choose the most attractive markets and ways of supplying them. We also see a broadening of the range of products we supply to our consumers as a part of this same picture.

The year 2005 will enter the history of Gazprom as the year we started construction of the Northern European pipeline. This project is a step towards a qualitatively new approach to export policy, marked by a crucial decrease in the transit risk involved in transporting gas from Russia to Europe.

The gas pipeline across the Baltic Sea will provide a direct connection from Gazprom's transport network to the transport networks of Europe, our tangible and significant contribution to safeguarding the energy security of the countries of Europe.

A further way of enhancing the reliability of supply to Europe is by another route, the "Blue Stream" pipeline via Turkey. In its export planning Gazprom regards transit of Russian gas to Southern Europe and the countries of the Eastern Mediterranean as a promising development which will build on new contracts and new volumes of gas.

We often hear grumblings about the high price of gas in Europe. As we see it, this is mainly a question of how profit is distributed amongst the various links in the chain between production and sale of the gas to the end-user. For European consumers, the lion's share of the prices they pay is taxation. Perhaps it is here that we could find room for cutting prices!

We have everything we need to fulfil completely all our commitments in Europe, remaining the main supplier of gas to European consumers, while developing in parallel our promising relationship with companies in the Asia-Pacific region. What shape the emerging world energy market will take is something we will find out in the next few months, rather than years. Taking into account Gazprom's resource base, we can state with absolute confidence that our company can offer a solid foundation to offer the energy supplies needed for the development of Europe (and the world).

In conclusion I should point out that Gazprom is a company with the will to devote its resources to tackling international energy problems. Gazprom is a company with the structure and the production capacity to guarantee success whatever unfavourable turn the world economy or the political situation might take.

There are only three countries capable of being a long-term supplier of gas: Russia, Iran and Qatar. When it comes to gas for the development of the European economy, there is no realistic alternative to Russia. Objectively speaking, there is no disputing the geographical closeness of Russia and her European consumers, and the pipeline system supplying gas to Europe is the cheapest and economically the most efficient way of transporting that gas.

Gazprom is ready for a positive discussion on any issue connected to the supply of Russian gas, and it is our intention to use our colossal potential in the interests of our partners and of our shareholders -- the most important of which, I would remind you, is Russia itself.