

## **Press Conference Background**

### **GAS SUPPLY TO DOMESTIC MARKET. EXECUTING RUSSIAN REGIONS GASIFICATION PROGRAM**

**(May 20, 2014)**

#### **GAS SUPPLY TO DOMESTIC MARKET**

Gazprom Group is the largest gas supplier to the domestic market and operates exclusively in its regulated segment.

In 2013 Gazprom Group sold 228.1 billion cubic meters of gas – an 8.7 per cent fall versus 2012. The main reasons for the decline in gas supply are abnormally warm weather conditions during the whole year (especially in Q1 and Q4, which affected gas consumption) as well as an increase in gas supply by independent producers.

Gazprom's proceeds from gas sales in the Russian market reached RUB 774 billion in 2013 surpassing the 2012 level by 4.5 per cent. Gazprom's average gas selling price in the domestic market also rose versus 2012 by RUB 428.8 and totaled RUB 3,393 per 1,000 cubic meters.

Gazprom is committed to improving the pricing mechanism for natural gas. The Russian Federation Government is looking at possible updating of the Basic Provisions of Formation and State Regulation of Gas Prices and Transmission Service Tariffs in the Russian Federation (following Russian Government Directive No. 1021, dated December 29, 2000). The updates are aimed at promoting competition in the Russian natural gas market and stipulate a possible wholesale price reduction by up to 15 per cent for the industrial consumers in the domestic market.

In addition, Gazprom jointly with the Russian Energy Ministry is working on establishing the mechanisms of well-coordinated gas trade (exchanges and trading systems). In order to increase the efficiency and fairness of trade, it is necessary to make amendments into regulatory documents aimed at creating equal business conditions in the gas market for all its players as well as at increasing the customers' responsibility for offtaking less gas than fixed in the gas supply agreement. This trade, if resumed, will make it possible to obtain market indicators necessary for streamlining the gas price formation system.

In 2013 Gazprom Mezhhregiongaz Group sold 265.4 billion cubic meters of gas provided by Gazprom and other producers, which is 8.9 per cent less as compared to the 2012 level.

The socially significant consumer groups, including utility companies, population and budget-financed companies were supplied with 77.8 billion cubic meters of gas (excluding entities partially operating as utilities), which accounts for about 30 per cent

of total gas supplied by the regional gas trading companies of Gazprom Mezhrefiongaz Group.

32.1 billion cubic meters of gas was supplied to consumers in 2013 at the prices set in the Russian Government's Directive No. 333 (dated May 28, 2007), out of which 21.3 billion cubic meters (66 per cent) was sold at the prices agreed with consumers to be lower than the ultimate maximum level. Generally throughout Russia the excess of the contractual wholesale price over the maximum wholesale price fixed by the Russian Federal Tariff Service accounted for some 3.3 per cent. The current plans for selling additional gas volumes in 2014 come to 37.2 billion cubic meters.

Gazprom takes steps for increasing its market share by developing the gas supply system in the Far Eastern Federal District. Sustainable efforts are being made for further development of such regions as the Kamchatka and Primorye Territories, the Sakhalin Region. In 2013 the total volume of gas supply to the consumers of the Far Eastern Federal District as compared to 2012 grew by 28.6 per cent up to 1.8 billion cubic meters. It is planned to supply 2.3 billion cubic meters of gas to the Far Eastern Federal District in 2014.

One of the most crucial problems Gazprom is facing in the domestic market is the growing consumer debt for the supplied gas. In 2013 the overdue debt of all consumer groups to Gazprom Mezhrefiongaz Group rose by RUB 32.8 billion and amounted to RUB 115.8 billion. During Q1 2014 the overdue debt grew by another RUB 25.8 billion up to RUB 141.6 billion.

The growth of debt owed by socially significant consumer groups makes up RUB 27 billion and exceeds the total increase due to the reduction of debt by power generating companies. As of April 1, 2014 the socially significant consumer groups account for the total of 75 per cent in the overdue debt structure:

- population – RUB 52.6 billion;
- utility companies – RUB 46.2 billion;
- budget-financed companies – RUB 6.5 billion.

Of the total indebtedness of the population the North Caucasian Federal District accounts for 80 per cent.

The highest overdue debt of utility companies falls on the Moscow Region, the Republic of North Ossetia-Alania, the Krasnodar Territory, the Republic of Kabardino-Balkaria, the Tver, Tula, Vladimir, Bryansk Regions and the Republic of Bashkortostan.

The main reasons for debt formation by utility companies are as follows:

- intermediaries represented by managing companies within the chain of population payments for heat (money doesn't reach the gas supplier);
- deliberate bankruptcy of private operators of heat production companies;

- economically unjustified heat rates in the regions (which do not match the actual costs);
- obsolete heat production equipment and heat supply networks.

The level of payments by budget-financed companies is high, except for the entities of the Ministry of Defense. As of April 1, 2014 their overdue debt amounted to RUB 5.4 billion, the total overdue debt of this consumer group being RUB 6.5 billion.

Among the power industry companies the main debtor is represented by TGC-2. As of April 1, 2014, its overdue debt with the account of subsidiary companies totaled RUB 6.9 billion, the total overdue debt of the power industry companies being RUB 12.1 billion.

In 2013 Gazprom Mezhregiongaz Group filed claims (notices) against debtors in the amount of RUB 161.9 billion. Legal actions worth RUB 66.1 billion were initiated. Court rulings were made in respect of RUB 46.5 billion. As a result of the enforcement procedures RUB 49.7 billion was collected. Debts amounting to RUB 9.3 billion were transferred from the insolvent legal entities to solvent ones, and transferred debts totaling RUB 6.7 billion were paid.

However, debts recovery by the claim-related work proved to be insufficiently effective. According to the established procedural periods it has a long period (at least 6 months), leading to growing debts to heat supplying companies and receipt of an unsecured commodity credit from Gazprom Mezhregiongaz Group. Further growth of debts frequently results in the uncontrolled bankruptcy of heat supplying entities in the absence of the source for repayment due on the accrued debt.

Therefore, upon the end of the 2013/2014 heating season Gazprom Mezhregiongaz Group was bound to envisage measures aimed at the limitation and termination of gas supplies to some 700 utilities (in 57 regions), who had failed to execute contract liabilities.

Another 159.7 thousand indebted consumers (individuals) were disconnected from gas supplies in 2013.

## **EXECUTING GASIFICATION PROGRAM**

Executing Russian regions gasification program is one of Gazprom's prioritized activities. Since 2005 the functions of the investor, coordinator and organizer of Russian regions gasification programs were entrusted to Gazprom Mezhregiongaz.

From 2005 to 2013 Gazprom's total investments in the Gasification Program made up approximately RUB 214 billion (excluding funds channeled to the construction of gas branches and gas distribution stations being an integral part of the regional gasification process). Investment figures came to RUB 33.9 billion in 2013.

As a result of the Russian Regions Gasification Program executed between 2005 and 2013, Russia's average gasification level rose from 53.3 to 65.3 per cent, including from 60 to 70.9 per cent in cities & towns and from 34.8 to 54 per cent in the rural area.

Between 2005 and 2012 Gazprom secured gasification of 3,623 boiler houses, over 600 thousand apartments and households, and in 2013 (in view of full compliance with obligations by regional authorities) – another 400 boiler houses and 72 thousand apartments and households.

In general, since 2005 almost 1.7 thousand inter-settlement gas pipelines with a total length of 24 thousand kilometers were constructed.

As part of the Gasification Program Gazprom is constructing inter-settlement gas pipelines, while regional authorities are responsible for preparing customers for gas supplies. In the process of the Program execution the majority of the Russian Federation constituent entities are lagging behind in implementing their part of liabilities. The regions' failure to prepare consumers for gas supplies as well as enormous debts of consumers forced Gazprom to reduce the Gasification Program investment for 2014.

Presently, the investment volume is determined at a level of RUB 27.6 billion – 18.6 per cent less than in the past year. Gazprom had to exclude from the Program the gasification funding in several areas: the Arkhangelsk, Astrakhan, Vladimir, Volgograd, Moscow, Penza, Smolensk, Tver, Ulyanovsk, and Yaroslavl Regions as well as the Republic of Ingushetia.

The Company's investments in the regional gasification will be adjusted during the current year depending on the execution of obligations by regional authorities on the preparation of consumers for gas supplies and the payment of accrued debts for the supplied gas.