Financing the security of supply

Opportunities and Challenges in Russia

November 2007

GAZPROMBANK

Joint-Stock Bank of the Gas Industry

Financing the Security of Supply

- Clichés and Reality
- Security of Supply...and Demand
- Financing Projects in an evolving framework

Clichés and Reality

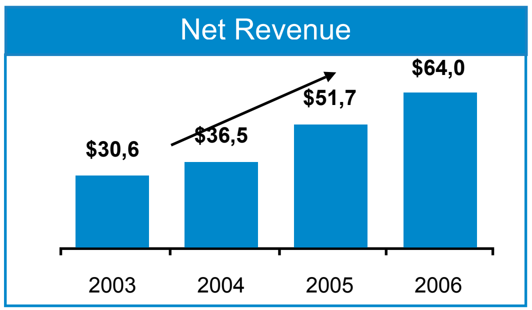
"The Russian energy sector is increasingly state-dominated and inefficient..."

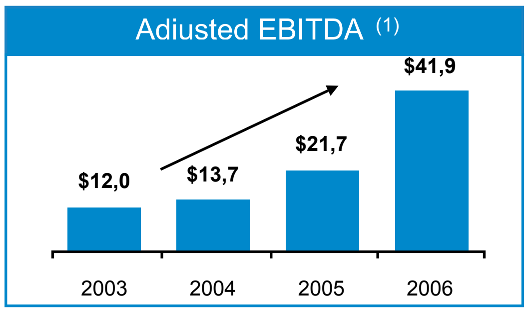
- **A diversified industry**
  - Independents control over 40% of gas reserves, control 29% of the domestic gas market, and their share is projected to increase to 45% by 2010
  - Many companies, with private and public shareholding
- **Clarification of government policies**
  - Official policy concerning large projects clarified
  - Laws implemented or announced
- **Liberalization of prices**
  - Oil prices liberalized
  - Regulated gas prices phased increases until 2011
  - Regulated power prices phased increases until 2011
- **Introduction of free gas and power markets**
  - Electronic trading systems since 2006, with phased increase of free market sales
- **Privatization of the Power infrastructure**
- **Concession law** introduced in July 2005

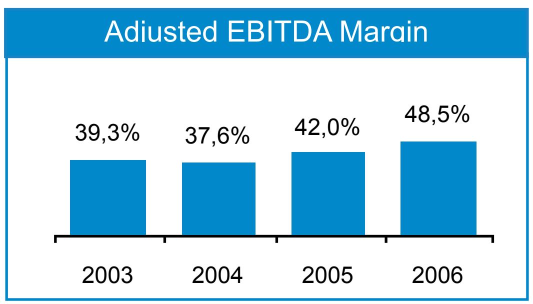
Clichés and Reality

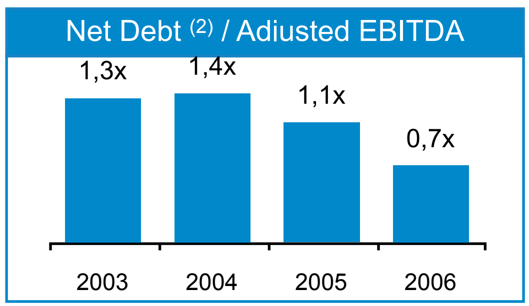
"Gazprom is an inefficient state-owned monopoly..."

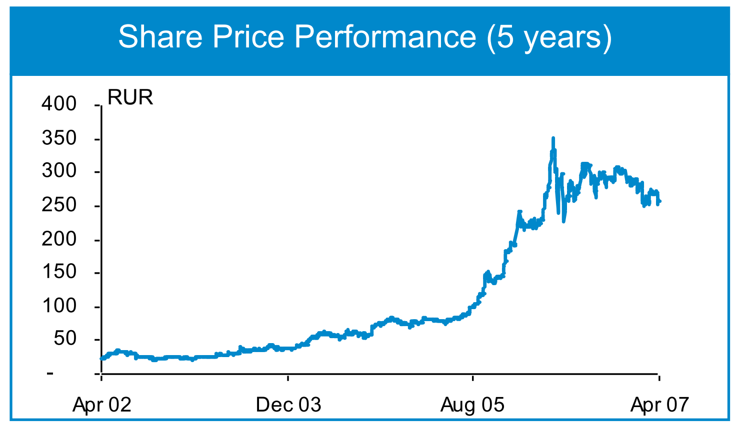
- **Focus on maximizing shareholder return**
- **International Integrated Energy Company strategy**
  - strategic acquisitions at below USD 2/boed
  - investments in power industry
  - focus on energy savings
- **Transparent communication**
- **Joint ventures and partnerships**











Gazprom's market capitalization has increased from USD 15 billion in 2002 to USD 240 billion in 2007

Clichés and Reality

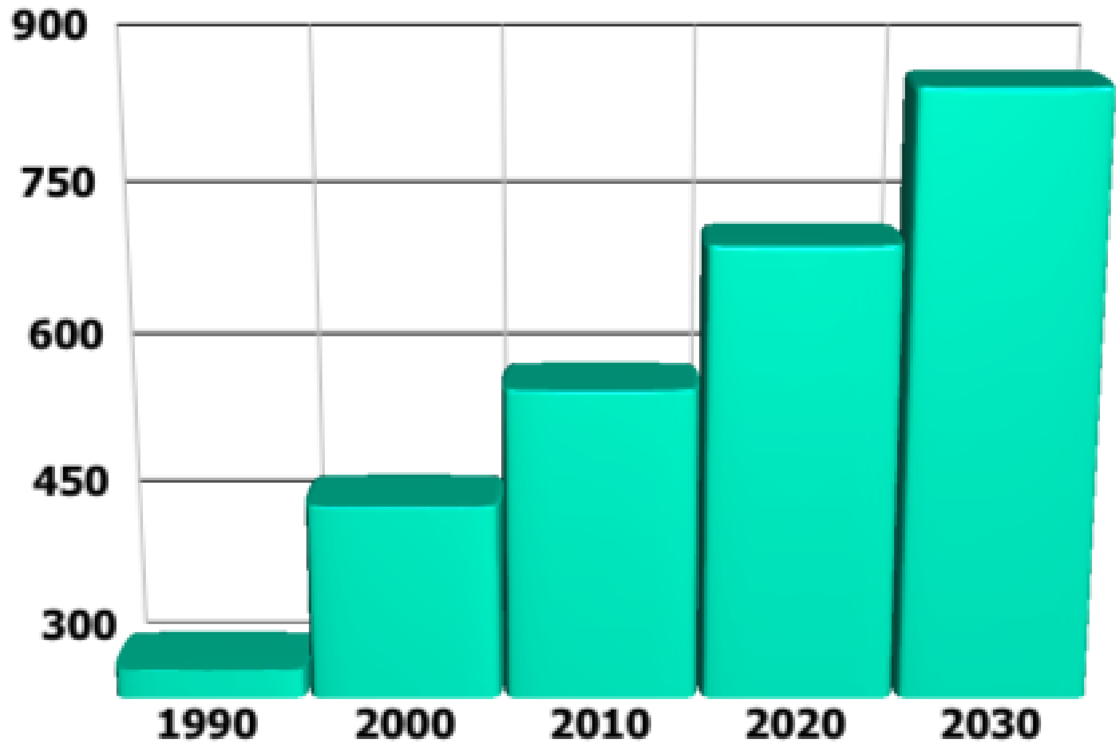
"Russia is using gas as a political weapon"

- Gazprom has a stated policy to sell gas at market prices
- The "transition" has lasted over 15 years
- In many cases, Gazprom has negotiated lower prices in exchange for an interest in transit pipelines
- The establishment of market prices benefit all shareholders of Gazprom, but paradoxically deprive Russia of geopolitical influence

Security of Supply... and Demand

Concern of buyers:

- Availability of gas in future years as demand in Europe is expected to increase while the production of existing fields is projected to decline
- Reliability of gas deliveries: protection against delivery interruptions



OECD Europe Gas Consumption in BCM/year

Source EIA, International Energy Outlook 2006

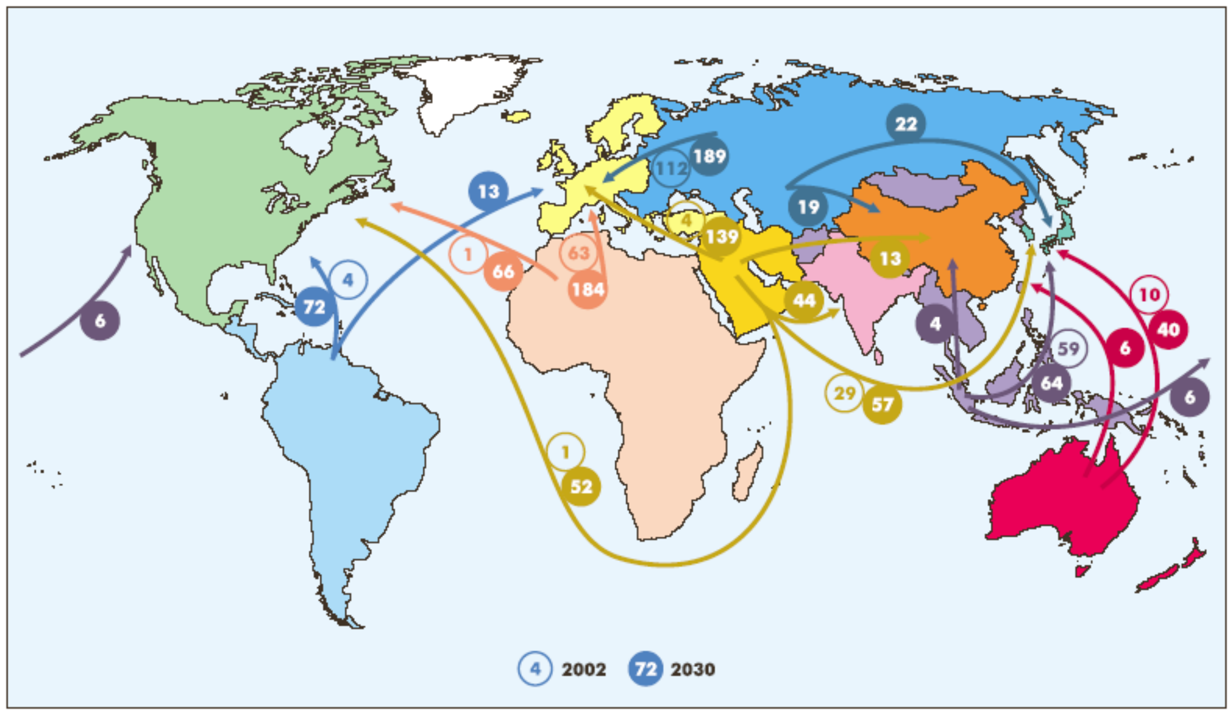
Security of Supply... and Demand

Concern of Sellers:

- Access to end-user markets
- Long Term contracts to cover investments
- Secure best prices

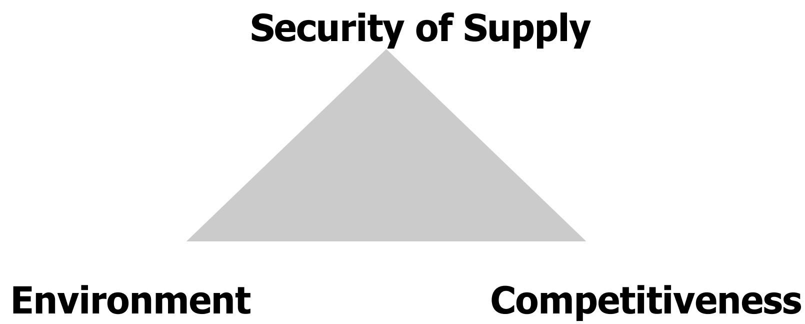
Major Net Inter-Regional Natural Gas Trade Flows, 2002 and 2030 (bcm)

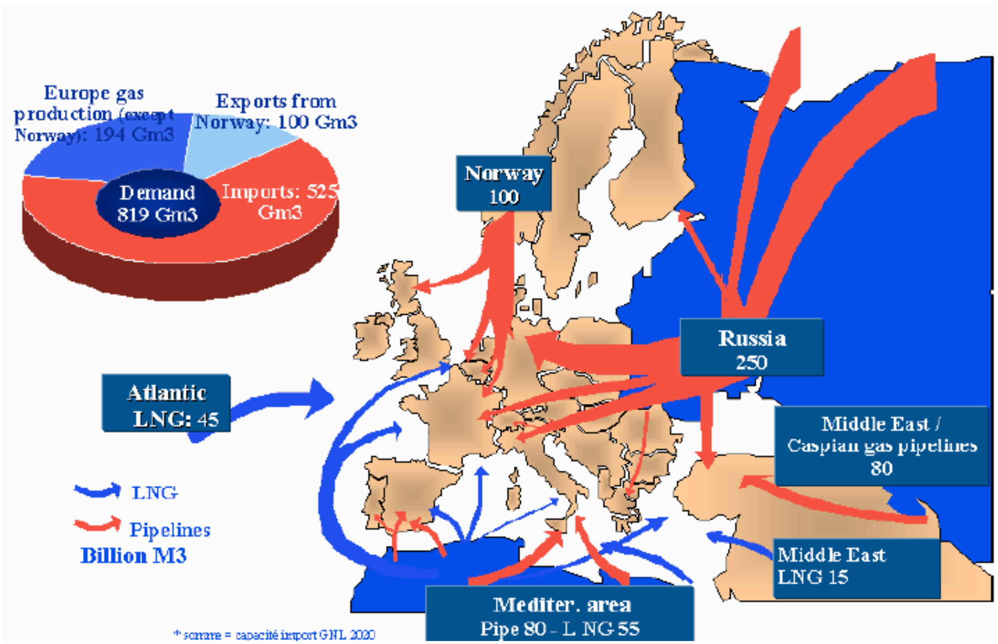
Source IEA, World Energy Outlook 2004



Security of Supply... and Demand

Concern of Regulator:





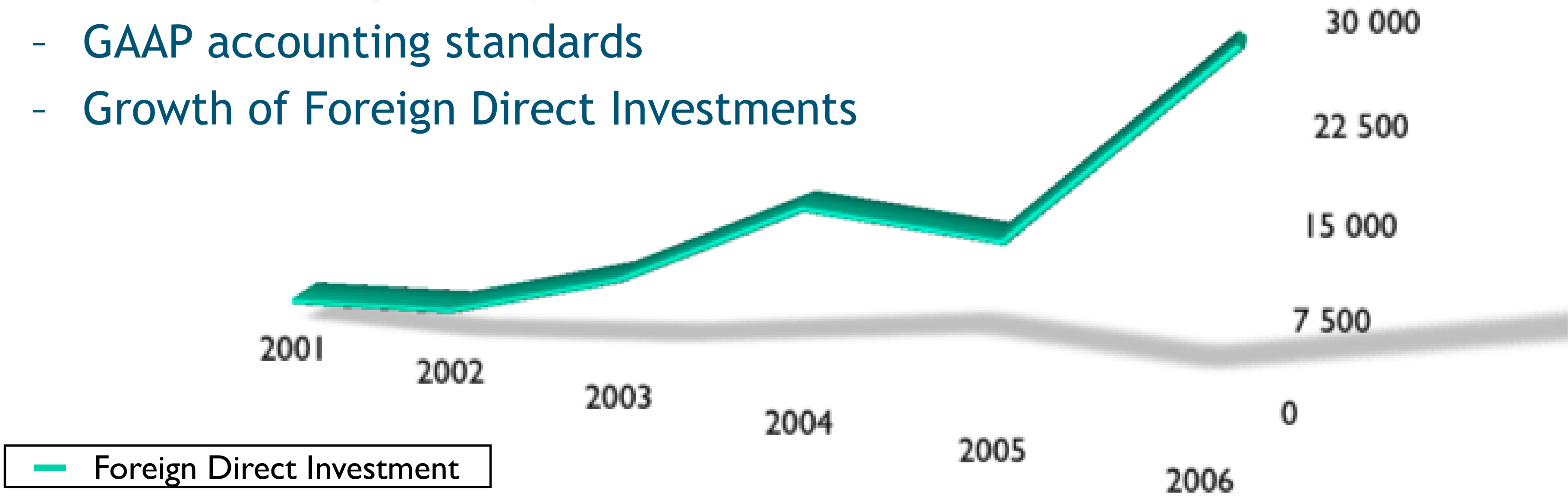
Concern of Lenders:

- Cash Flows to cover hundred of billions investment costs for Europe's gas infrastructure
- Legal and regulatory framework

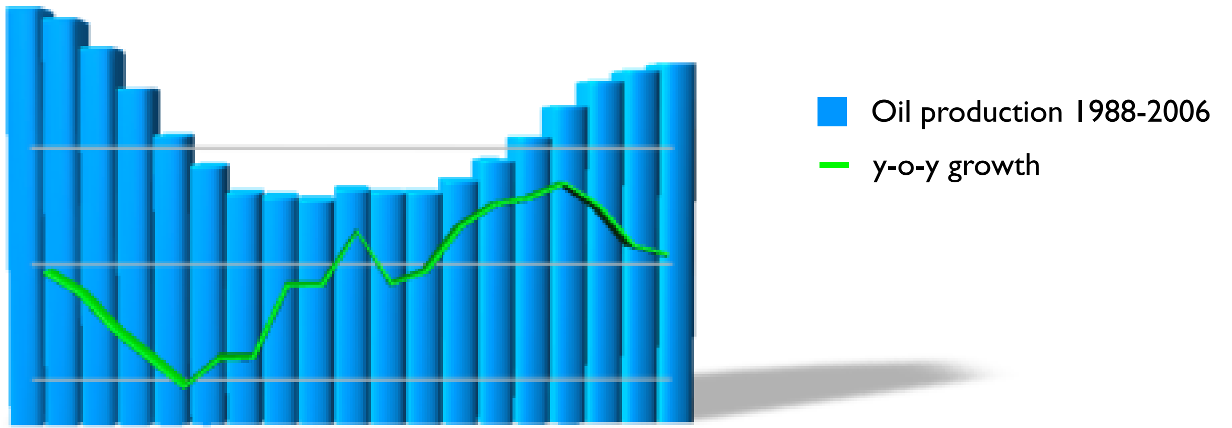
Centre for European Policy Studies, Patrick Cayrade, Indes Working Paper 3/04

Opportunities in Russia: an Investment Growth Context

- **A favorable macroeconomic context**
  - Eight years of significant growth
  - Growth now goes beyond greater use of idle industrial capacity and requires new investments
  - Government stability
  - Improved corporate tax regime
  - Reversal of capital flight
  - GAAP accounting standards
  - Growth of Foreign Direct Investments



The challenge of financing the future growth



- **Oil & Gas investment required**
  - The "Easy Capex" accelerated production in the early 2000's, but continued growth of oil production will require over USD 15 billion/ year in investments over the next few years
  - The combined capex of the four largest Russian oil companies have increased by 250% in the last five years. For 2007, all major companies forecast 30% to 50% increases
  - Gazprom has launched a Capex program of over USD 420 billion by 2030 and independents, with almost half of Russian gas reserves also have very large capex plans.

In a rapidly evolving financial framework

- **The ruble convertibility and suppression of currency controls significantly changes the perspective on RUR revenues and costs**
  - RUR revenues are no longer an issue
  - Arbitrage between local and international contractors is no longer constrained by currency
- **Foreign currency reserves and foreign exchange policies provide basis for currency stability but present new challenges**
  - RUR appreciation
  - sustainability of stabilization mechanisms
  - search for hedging,...)

A rapidly evolving financial framework

- **Russian credit markets are evolving significantly**
  - Russian banks are able to provide longer term, more sophisticated financing
  - International banks operating in Russia can offer some RUR funding as well
  - Russian official support for Russian exports becoming significant
  - the Role of IFIs in Russia is also evolving

- **Capital markets, pension funds, private equity are additional players**
  - Russian and international investors active through capital markets, private equity, bond markets, in RUR.

Financing projects: funding sources

- **Equity:**
  - Certain investments can only be financed through equity or are best financed through equity:
    - Time constraints
    - Lack of identifiable cash flows
    - Regulatory constraints
    - Requirements of partners
    - Cost analysis
- **Mezzanine:**
  - Hybrid loans, preferred shares, subordinated notes, convertible bonds can provide flexibility and enhance equity as well as debt solutions
- **Asset swaps:**
  - Assets swaps can be an efficient mean of securing assets at an interesting price without cash outflow

Financing projets: funding sources

- **Corporate debt:**
  - Access to the markets can provide competitive funding :
    - Bank loans
    - Asset-backed finance
    - Bond markets
    - Funds
    - Multilaterals
- **Limited Recourse Financing:**
  - Project Financing can provide large amounts for identified projects:
    - Frees up the balance sheet of the sponsors post completion by making efficient use of project cash flows
    - Allocates the risks to the most appropriate parties
    - Allows the benefit of available third parties risk mitigation (ECAs, multilaterals, Private insurance,…
    - Promotes transparency

Lessons from real Life

- **History of financing projects in Russia and the CIS**
  - In the 1990's financing was based on collateral, intra-group relationships, trade finance, and export finance
  - Export-oriented projects could attract some forms of structured finances
  - The largest Russian companies have increasingly been able to attract financing on a corporate basis from international banks
  - CIS banks have been able to finance limited recourse, but generally collateralized facilities for local clients
- **Little interaction between CIS and International Banks**
  - International banks found it difficult to finance non-export oriented project
  - Banks in the CIS had limited capacity to intervene in larger scale projects
  - Investment in CIS was limited by the ability to restore use of idle infrastructure as well as deterrents to investment

Project Finance in Russia and the CIS today

- **The Russian project financing needs today: convergence of domestic and international experience**
  - Domestic projects with RUR revenues abound
  - International and Russian banks provide complementary services to projects
  - Projects with Russian sponsors or contractors abroad provide further ground for joint work
- **A new CIS framework**
  - Many of the CIS economies have significantly evolved and have integrated within a regional context:
    - pipeline projects
    - integration of oil & gas fields in regional plans
    - diversification of routes and markets
    - new pricing mechanisms

Thank You!

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