

MNC from the North Pole



***Indra Adhikari
Jonah Arut
Mandeep Gill
Shen Tian***

July 2014

Table of content

1. INTRODUCTION	3
1.1 MISSION OF GAZPROM	4
1.2 A COMPANY STRUCTURE DIAGRAM	5
1.3 GOVERNMENT SUPPORT	5
2. GAZPROM BUSINESS EMPIRE.....	6
Pic 2.1: Gazprom projects outside Russia.....	7
Pic 2.2: Major gas pipelines to Europe.....	7
Table 2.1: Gazprom's share in Russian fuel and energy industry.....	7
Table2.2: Gazprom's share in the world gas industry	8
Table 2.3: Share in the Russian fuel and energy complex	8
2.1 BUSINESS SEGMENTS.....	8
2.2 <i>Hydrocarbon Production</i>	9
<i>Chart 2.1: Hydrocarbon Production in Russia (in million tce)</i>	9
2.3 ELECTRICITY AND HEAT GENERATION	10
Chart 2.2: heat and electricity generation.....	10
2.4 SALES	10
Chart 2.3: sales shares	11
Chart 2.4: historical gas sales figures.....	11
Chart 2.5: Gas sales in Russian market	12
Chart 2.6: Gas Sales to Europe Market (RR billions).....	12
Chart 2.7: Gas sales in FSU countries.....	13
2.4 GAZPROM GLOBAL POSITION	13
Chart 2.8: Gazprom compared to other companies	13
3. FINANCIAL RESULTS	14
Chart 3.1: Historical net sales and profit.....	14
3.1 DEBT OVERVIEW	15
Chart 3.2: Total debt.....	15
Chart 3.3: Debt maturity profile	15
Chart 3.4: Cost of debt financing	16
3.2 BALANCE SHEET	16
Chart 3.5: Financial Ratios & Market Indicators	18
3.3 INCOME STATEMENT.....	18
3.4 STATEMENT OF CASH FLOW	19
4. KEY SUCCESS FACTORS	20
4.1 GAS/PETRO PRODUCTS DEMAND IN EUROPEAN COUNTRIES	20
Chart 4.1: Investment in gas distribution network expansion in Russian region	21
4.2 HUMAN RESOURCE MANAGEMENT.....	22
4.3 SOCIAL ENGAGEMENT.....	22
4.4 INVESTMENT IN R&D	23
5. SWOT ANALYSIS	23
5.1 STRENGTH	23
5.2 WEAKNESS	24
5.3 OPPORTUNITIES	24
5.4 THREATS	25
6. TOWS MATRIX.....	26
6.1 SO STRATEGIES	26
6.2 ST STRATEGIES	26
6.3 WO STRATEGIES.....	27
6.4 WT STRATEGIES	27
7. RECOMMENDATIONS.....	27
REFERENCES	29

1. Introduction

Gazprom Group is one of the world's largest gas and oil companies in terms of reserves, production and market capitalization. Gazprom (originally **Gazovaya Promyshlennost**) was created in 1965 at the initiation of the then USSR gas ministry. In its initial years, the company concentrated on gas production. Despite the transfer of many assets to nationalized companies such as UkrGazprom and Turkmen Gazprom after the collapse of the USSR, Gazprom continued to rule the gas market in the region. Its influence in politics increased after 1992 when Boris Yelstin appointed the company's chairman Chernomyrdin as a Prime Minister.

The new government initiated the privatisation of the company 1992. The following year, Gazprom became a joint -stock company. In two years time, 33 % of the company's shares were sold to the public and another 15 % were allocated for employees. The company gradually opened to Western investments after the issue of US\$2.5 billion bond issue in 1997. After this, the ownership ratio has drastically changed. Public own 23 % shares, the government owns 50 percent and Bank of New York Mellon owns 27 percent of the shares (Management discussion paper, n.d).

Gazprom is a good illustration of what a national champion can achieve. Just before the global financial crisis, Gazprom was the highest earning company in the world; and in between 1999 and 2007, the market capitalization of the company skyrocketed making it a valuable publicly traded company.

It is the jewel in the crown of Russian business. Its major business lines are, gas and oil production, transmission, storage and sale of gas and other petroleum products all over the world. Gazprom produces about 8 % of the country's GDP and contributes about 25 % of all tax revenues to the federal budget.

The company owns the largest gas distribution system in the world. The Unified Gas Supply System (UGSS) represents a unique engineering complex encompassing gas production, processing, transmission, storage and distribution facilities. The UGSS includes 168,300 km of gas trunk lines and laterals, 222 line compressor stations with 3,738 gas compressor units and 25 underground gas storages (Transmission: Unified Gas Supply System of Russia, n.d). It holds the world's largest natural gas reserves (Gas and oil reserves, n.d).

Gazprom is the only company to produce and export liquefied gas in Russia. It sells more than half of the overall produced gas to Russian consumers and exports gas to over 30 countries.

1.1 Mission of Gazprom

Gazprom's mission is to provide a reliable, efficient and balanced supply of natural gas, and other energy resources and their derivatives to consumers. Its strategic objective is to establish itself as a leader among global energy companies by entering new markets, diversifying its activities and ensuring reliable supplies.

Table 1 (below) gives the details of Gazprom's position in the industry.

Table 1

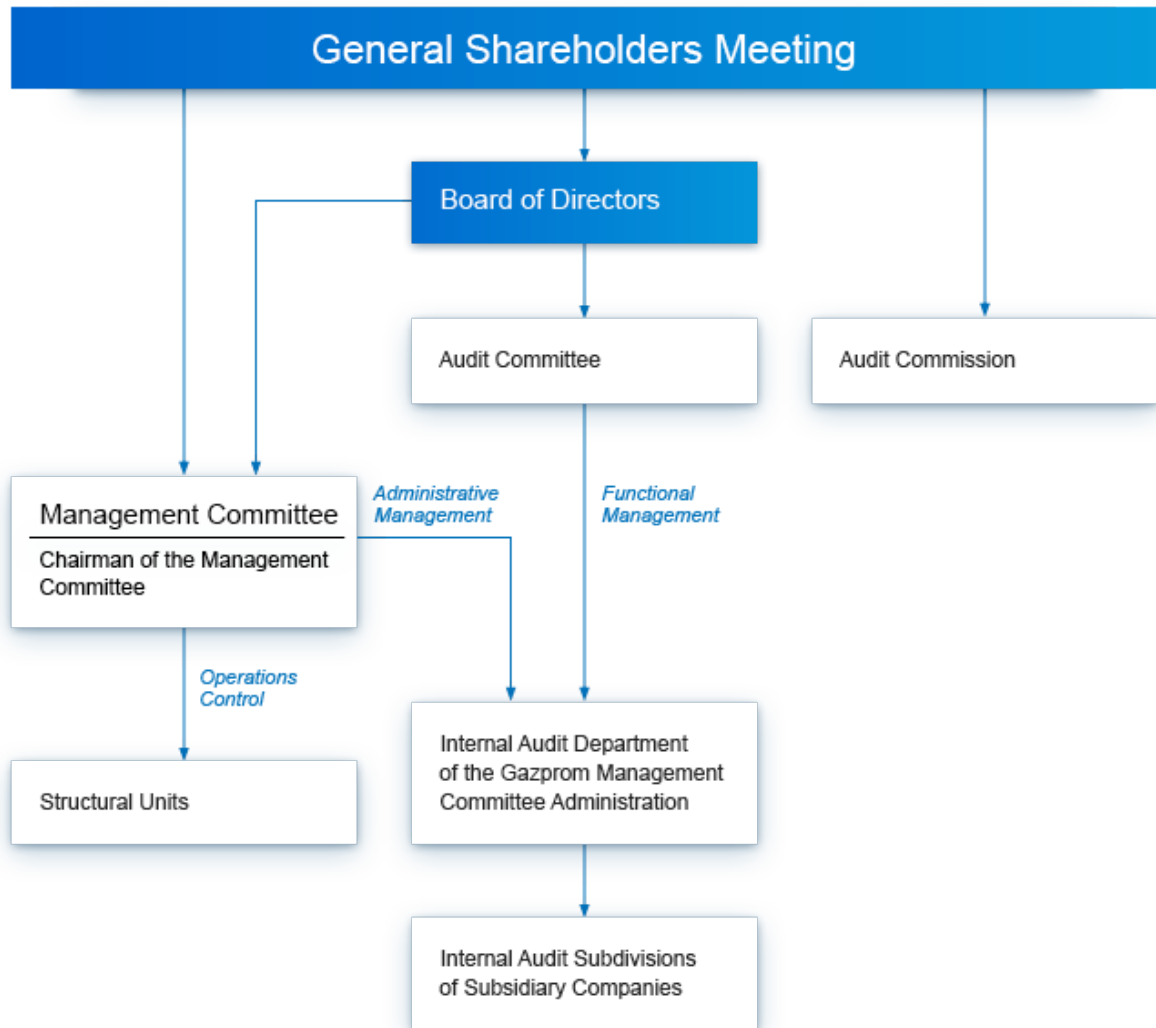
Gazprom's Position in the Global Gas Industry

OAO Gazprom ADR OGZPY											
<div> Add to Portfolio Get E-mail Alerts Print This Page PDF Report Data Question </div>											
<div> Quote Chart Stock Analysis Performance Key Ratios Financials Valuation Insiders Ownership Transcripts NEW Filings Bonds </div>											
<div> Overview Company Profile Industry Peers </div>											
<div> <div> Stock Type Last Close 06/03/2014 Fair Value Estimate Morningstar Rating </div> <div> — \$8.24 — </div> </div>											
<div> Industry Peers OGZPY <div>Get Price Quotes >></div> </div>											
	Morningstar Rating	Market Cap \$Mil	Net Income \$Mil	P/S	P/B	P/E	Dividend Yield%	5-Yr Rev CAGR%	Med Oper. Margin%	Interest Coverage	D/E
OAO Gazprom (RUB)		95,354	1,139,261	0.6	0.3	2.9	—	9.8	30.2	35.7	0.2
Exxon Mobil Corporation	★★★★	431,112	32,180	1.0	2.4	13.7	2.6	-1.7	13.8	6413.3	0.1
Royal Dutch Shell PLC	★★	263,981	12,704	0.6	1.5	20.5	4.4	-0.5	9.4	60.1	0.2
Royal Dutch Shell PLC		261,750	12,704	0.6	1.4	20.3	4.4	-0.5	9.4	60.1	0.2
Royal Dutch Shell PLC		253,165	12,704	0.5	1.4	19.6	5.0	-0.5	9.4	60.1	0.2
Royal Dutch Shell PLC	★★	253,014	12,704	0.5	1.4	19.6	4.6	-0.5	9.4	60.1	0.2
Chevron Corp	★★★★	233,292	19,757	1.0	1.5	11.9	3.3	-3.5	15.7	—	0.1
PetroChina Co Ltd	★★★★	220,723	127,830	0.6	1.2	10.8	3.8	16.1	9.1	8.7	0.3
PetroChina Co Ltd		214,134	127,830	0.6	1.1	10.5	4.4	16.1	9.1	8.7	0.3
BP PLC	★★★	171,992	10,116	0.4	1.3	15.7	4.5	1.5	7.9	11.7	0.3
BP PLC		170,766	10,116	0.4	1.3	15.6	4.4	1.5	7.9	11.7	0.3
Total SA		158,833	13,041	0.7	1.5	12.2	4.6	1.2	13.2	30.5	0.4
Total SA	★★★	158,493	13,041	0.7	1.5	12.2	3.9	1.2	13.2	30.5	0.4
China Petroleum & Chemical Corp	★★★	107,496	63,576	0.3	1.2	11.1	3.8	14.0	4.2	10.0	0.2
China Petroleum & Chemical Corp		104,430	63,576	0.2	1.1	10.8	5.1	14.0	4.2	10.0	0.2
Eni SpA	★★★	102,877	4,959	0.6	1.3	13.8	4.7	1.3	14.3	3.1	0.4
Eni SpA		101,806	4,959	0.6	1.3	13.7	4.7	1.3	14.3	3.1	0.4
Statoil ASA	★★	97,891	57,200	0.9	1.6	10.3	3.7	-0.7	26.2	99.9	0.4
Petroleo Brasileiro SA Petrobras		96,594	9,520	0.7	0.6	10.1	—	3.6	18.7	6.0	0.8
Statoil ASA		96,297	57,200	0.9	1.5	10.1	2.9	-0.7	26.2	99.9	0.4
Petroleo Brasileiro SA Petrobras	★★★★	91,246	9,520	0.7	0.6	9.6	—	3.6	18.7	6.0	0.8
Ecopetrol SA		75,551	12,836,650	2.0	2.3	11.3	6.3	15.7	31.0	37.9	0.2
OJSC Rosneft Oil Co		68,675	447,000	0.6	0.7	5.1	3.2	20.3	18.8	55.6	0.4
Suncor Energy Inc	★★★	56,840	4,302	1.5	1.5	14.6	2.1	7.1	18.3	18.0	0.2
OAO Lukoil		44,182	6,984	0.3	0.5	6.5	2.2	5.6	10.1	22.4	0.1
Imperial Oil Ltd	★★★	41,956	2,976	1.3	2.2	15.4	1.0	0.8	11.8	55.2	0.2
Industry Average		63,234	189,355	0.7	1.5	13.3	3.5	6.9	-1370.7	-437.9	0.3

Source: MorningStar

1.2 A company structure diagram

Gazprom is a vertically integrated company, which dominates both upstream and downstream activities.



1.3 Government support

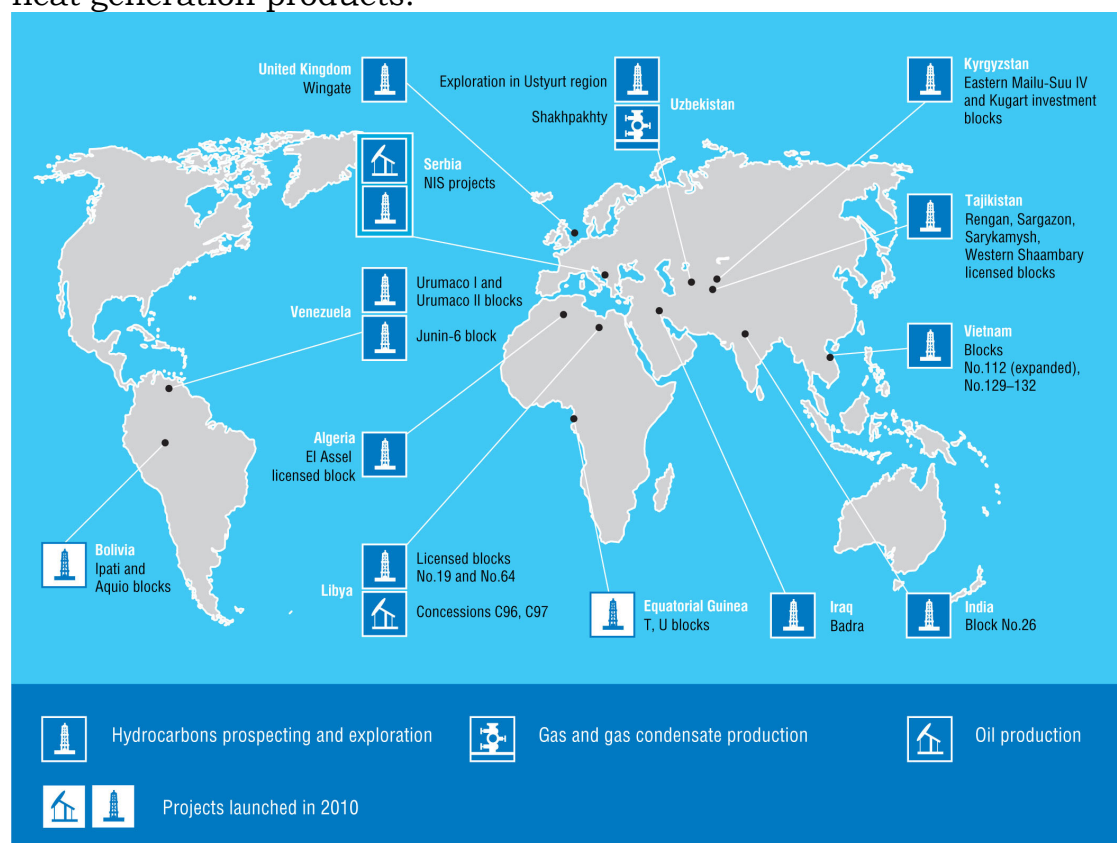
The company receives a huge government support. Unlike in traditional circumstances where government provides subsidy in the forms of monetary assistance to the company it controls, Gazprom did not receive monetary assistance rather received political and policy support to expand business. In 2005, the government established ownership on over 38 percent of the company. Following this, the government lifted the ban on foreign investment in the company. Ending the restriction on foreign investment means the company

became one of the attractive companies for foreign investment in Russia (BBC, 2005). The Russian government continued its policy to provide monopoly market for Gazprom through advocacy and policies (Bloomberg Businessweek, 14 March 2006; ICIS, 16 June 2006).

2. Gazprom Business Empire

Gazprom controls the biggest gas market in northern Asia and Eastern Europe. It is gradually expanding to central Asia such as China and Korea (Reuters, 19 April 2014). The market for Gazprom products expands to North America as well. Company's 248 subsidiaries adequately reflect the business empire created by Gazprom in the region.

Gazprom Russia is leading operator in all market and production activities while Gazprom subsidiaries in Belarus, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan play important role in the production and sales of hydrocarbon. Russia and Uzbekistan lead gas and condensate gas production of Gazprom while Russia headquarter controls the production of methane from coal beds. Gazprom (Russia) controls over the oil production while subsidiaries in Russia, Armenia, Belarus, Ukraine, Estonia, Georgia, Kazakhstan are engaged in gas transportation and marketing. The relatively new area of business, Gazprom Russia, Armenia and Lithuania produce electric power and heat generation products.



Pic 2.1: Gazprom projects outside Russia



Pic 2.2: Major gas pipelines to Europe

It controls almost three quarters of all gas reserves and gas production in this biggest country of the world. In the recent years, it has also increased its presence in crude oil and state gas condensate processing and electric power generation business.

The following table gives Gazprom Group's share in Russian fuel and energy sector performance in 2007—2011, in percentage.

Table 2.1: Gazprom's share in Russian fuel and energy industry

Items	2009	2010	2011
Controlled Russian gas reserves	69.8	68.7	71.8
Gas production	79.2	78.1	76.5
Oil and gas condensate production	8.4	8.6	8.4
Natural gas and APG conversion	47.6	49.9	48.6
Primary crude oil and stable gas condensate processing	15.5	16.5	17.2
Electric power generation	13.9	16.9	16.9

(Gazprom Sustainability Report 2010-2011, p15)

Considerable resource potential is one of Gazprom Group's most significant competitive advantages. Gazprom licensed fields located

primarily in Russia contain about 18% of the world's gas reserves and nearly 72% of Russian gas resources.

In 2011, Gazprom produced 513.2bn m³ of gas, 32.3mn tones of oil and 12.1mn tones of gas condensate in Russia. Gazprom is the largest domestic supplier and is responsible for more than 70% of the total gas supply. (Gazprom Sustainability Report 2010-2011, p16)

Similarly, the following table (next page) provides Gazprom Group's share in the world gas industry performance in 2009-2011, in %

Table 2.2: Gazprom's share in the world gas industry

Items	2009	2010	2011
Gas Reserves	18.0	17.6	18.3
Gas Production	14.5	14.8	14.5
Gas sales	22.1	20.1	21.0

(Gazprom Sustainability Report 2010-2011, p17)

Table 2.3: Share in the Russian fuel and energy complex

Share in the Russian fuel and energy complex	2008	2009	2010	2011	2012
Russian natural gas reserves controlled	68.9	69.8	68.7	71.8	72
Gas production	82.7	79.2	78.8	76.5	74.4
Crude oil and gas condensate production	8.8	8.4	8.6	8.7	8.9
Processing of natural and petroleum gas	59.1	47.6	49.9	48.6	47.6
Primary processing of oil and stable gas condensate	14.5	15.5	16.5	17.2	18.8
Power generation	10.5	13.9	16.9	16.9	16.2

2.1 Business Segments

Gazprom's operations are divided into the following principal businesses:

- Production of gas – exploration and production of gas.
- Transport – transportation of gas.
- Distribution – sales of gas within Russian Federation and abroad.
- Gas storage – storage of extracted and purchased gas in underground gas storages.
- Production of crude oil and gas condensate – exploration and production of oil and gas condensate, sales of crude oil and gas condensate.

- Refining – processing of oil, gas condensate and other hydrocarbons, and sales of refined products; and
- Electric and heat energy generation and sales.

The Group operates as a vertically integrated business with substantially all external gas sales generated by the Distribution segment (IFRS consolidated financial statements, 2012).

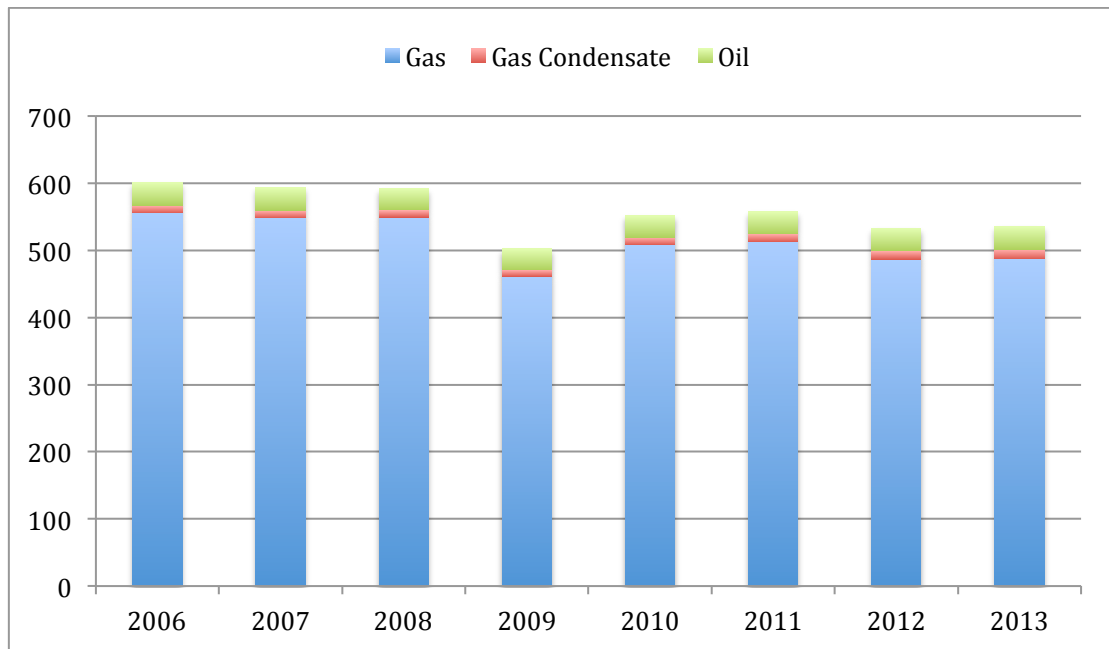
Other activities are grouped into inter-segment sales mainly consisting of:

- Production of gas – sales of gas to the Distribution and Refining segments;
- Transport – rendering transportation services to the Distribution segment;
- Distribution – sales of gas to the Transport segment for own needs and to the Electric and heat energy generation and sales segment;
- Gas storage – sales of gas storage services to Distribution segment;
- Production of crude oil and gas condensate - sales of oil and gas condensate to the Refining segment for further processing; and
- Refining – sales of refined hydrocarbon products to other segments.
- Internal transfer prices, mostly for Production of gas, Transport and Gas storage segments, are established by the
- Management of the Group with the objective of providing specific funding requirements of the individual
- Subsidiaries within each segment.

Their main business segments are mutually dependent, with a significant portion of the revenues of one segment comprising a part of the costs of another segment. For instance, the 'Distribution segment' purchases natural gas from the 'Production of gas' segment and transportation services from the 'Transport segment' and likewise to other arms of the business (Management discussion paper, n.d).

2.2 Hydrocarbon Production

Chart 2.1: Hydrocarbon Production in Russia (in million tce)

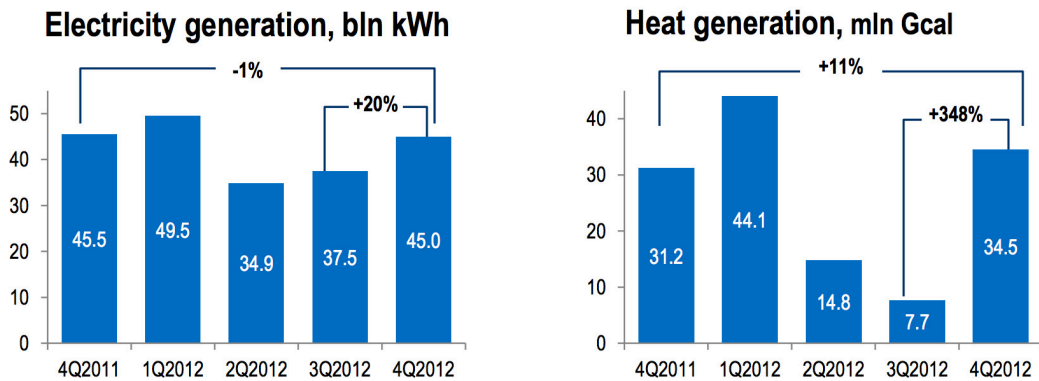


(Gazprom in figures 2006-2010: Factbook, n.d, p18 & Annual Report 2012, 2013)

After the slight decrease after the financial crisis, the production of gas and related products by the company has constantly increasing.

2.3 Electricity and Heat Generation

Chart 2.2: heat and electricity generation

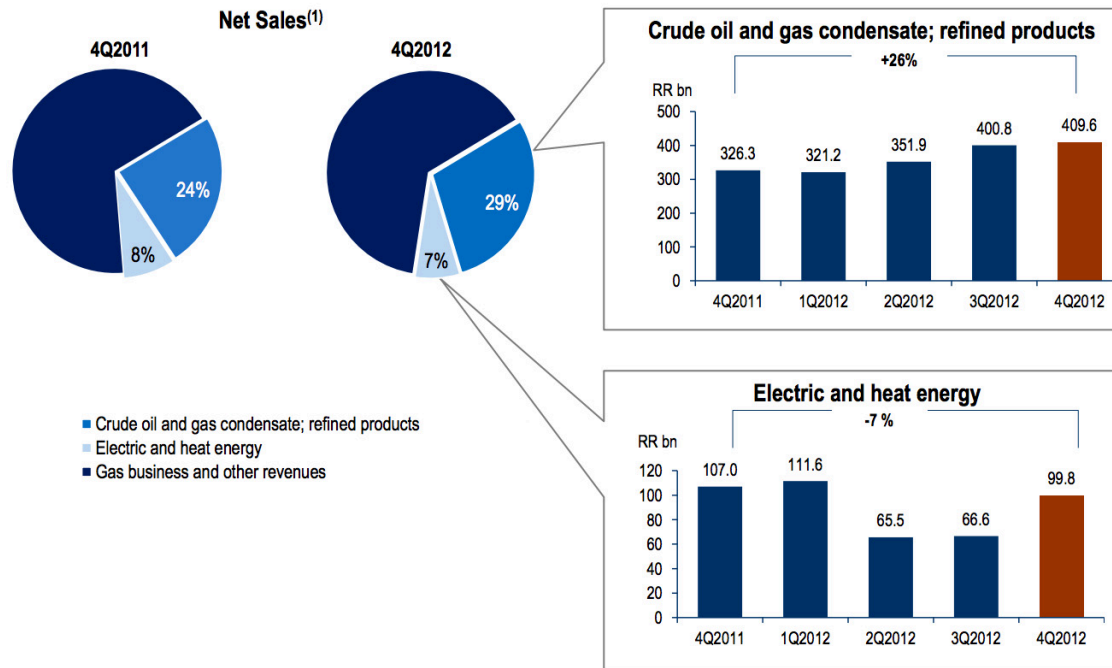


(Source: Ivannikov, 2012)

In 2012, natural gas production dropped by 4 % compared to the previous year due to the slackening demand in the key markets. The NGL production, however, increased by 13 % and crude oil by 2 %. The production data between 2011 and 2012 shows electricity remained slightly unchanged with a decrease in 1 % and heat generation experienced declined by 11 % compared to 2011.

2.4 Sales

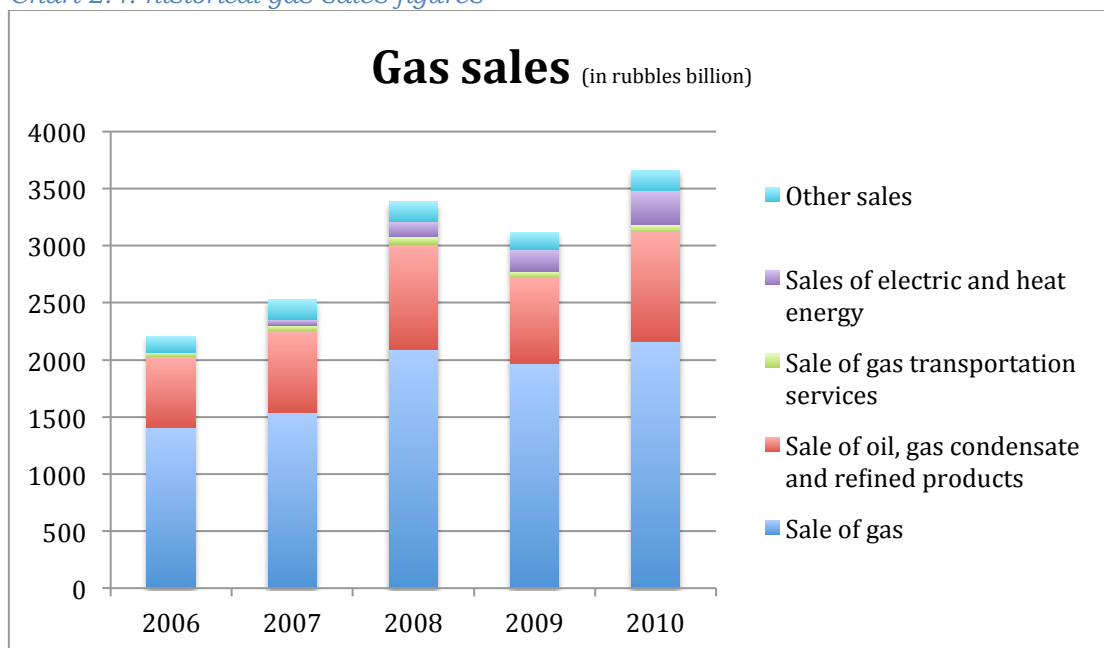
Chart 2.3: sales shares



(Source: Ivannikov, 2012)

The increase of net sales of crude oil, gas condensate and refined products was mainly caused by increase in volumes and prices for oil and refined products and change of scope of consolidation. The decrease of net sales of electric and heat energy was mainly caused by change of scope of consolidation.

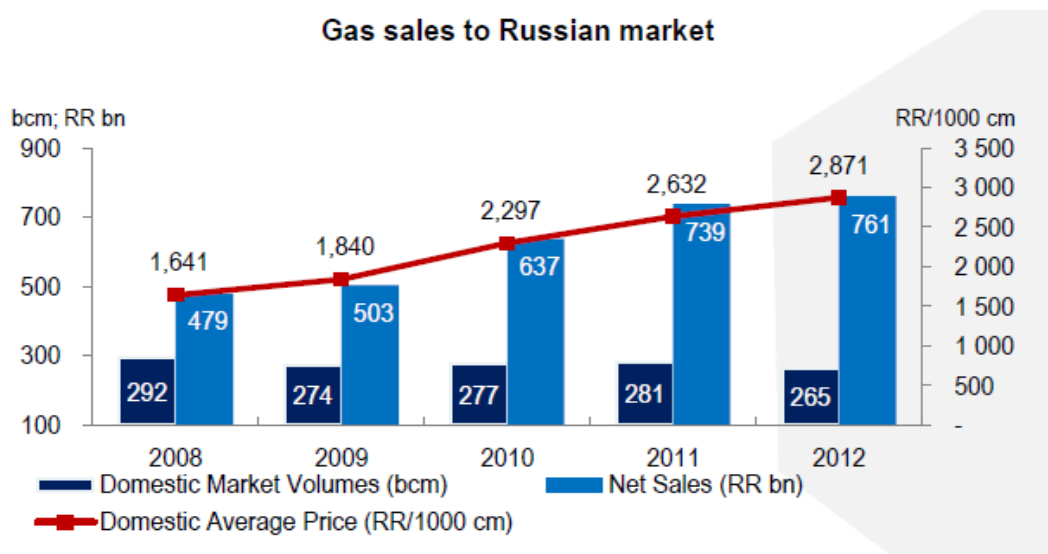
Chart 2.4: historical gas sales figures



(Source: Gazprom in figures 2006-2010: Factbook, n.d)

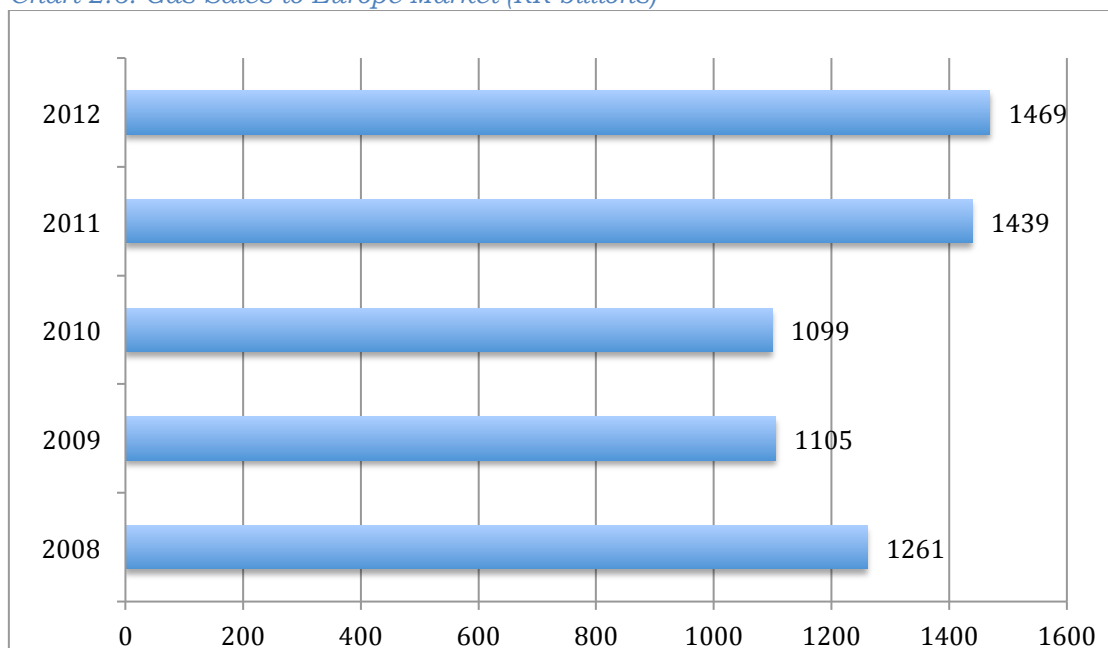
This chart shows the constant growth of the gas sales from the company posting a positive business future. The gas sales in both Russia and Europe have grown steadily while the sales to former Soviet Union countries remain fluctuating. Despite a slight drop in Europe market and FSU Country sales, 2012 saw a increase of sales in its domestic market mostly due to the planned raise of the domestic prices by 15% as of 01 July 2012. The volumes of gas sold in Europe and the former USSR republics showed growth, pushing revenues 14% and 11% up, respectively. The company targets to capture 32 percent of the gas market in Europe by 2030.

Chart 2.5: Gas sales in Russian market



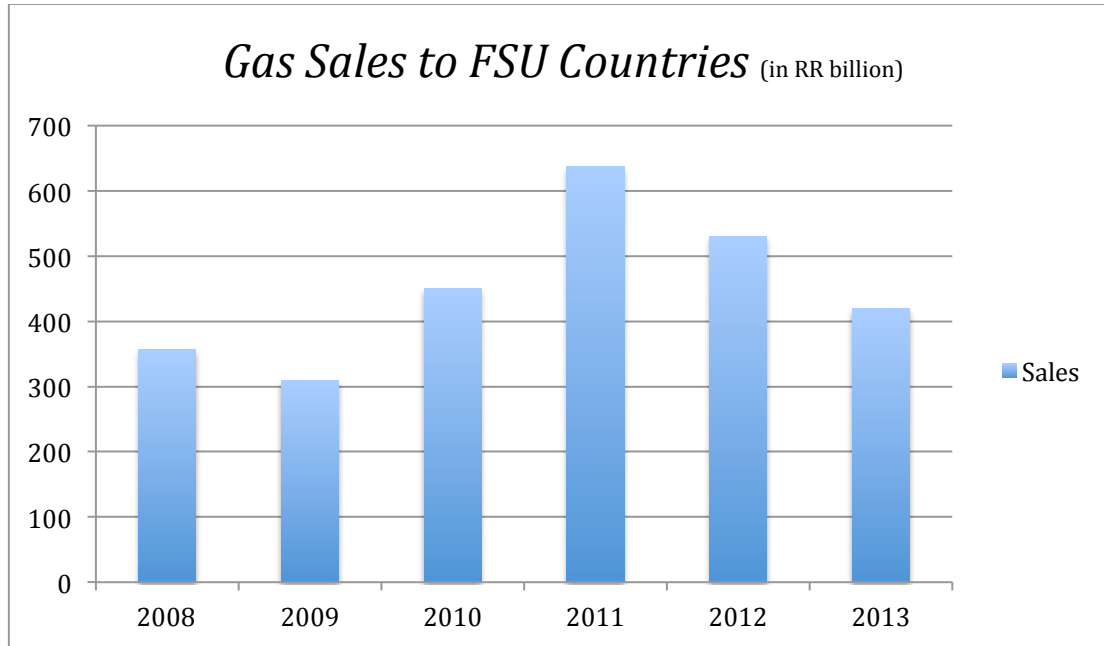
(Source: Ivannikov, 2013)

Chart 2.6: Gas Sales to Europe Market (RR billions)



(Source: Ivannikov, 2013)

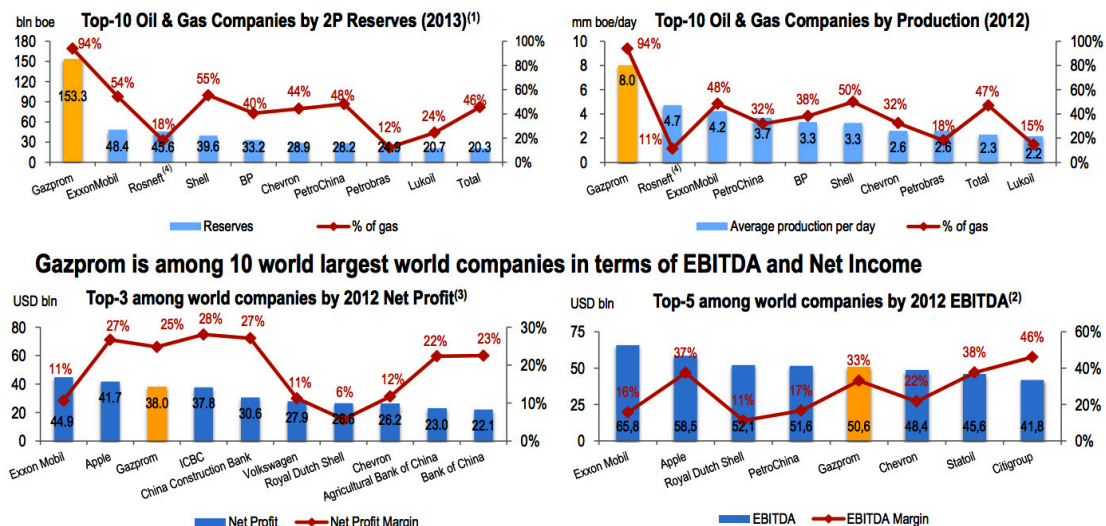
Chart 2.7: Gas sales in FSU countries



Source: (Ivannikov, 2013)

2.4 Gazprom Global Position

Chart 2.8: Gazprom compared to other companies



(Source: Ivannikov, 2012)

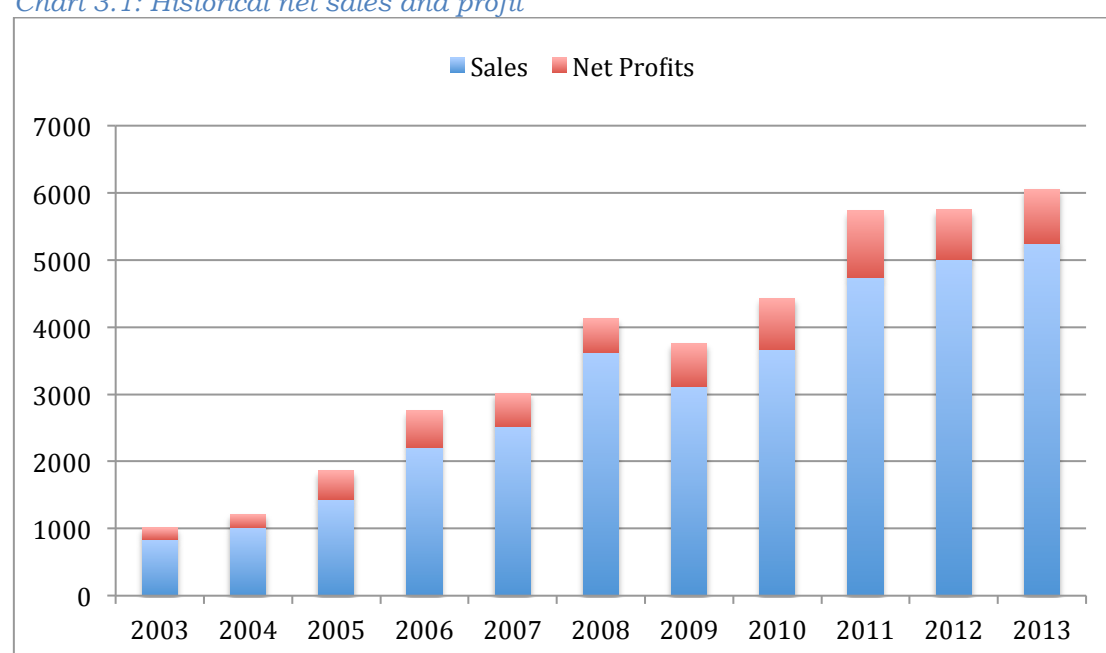
A report on 2012 Financial Results by Alexander Ivannikov, first deputy head of the finance and economics of the company in April 2013, claims that Gazprom was then the world's No.1 public oil and

gas company in terms of reserves and production. And it ranks third in terms of net profits figures and fifth by EBITDA and Net Incomes in 2012.

3. Financial Results

The company's historical records show that it has achieved constant growth in its sales and profit, except two years following financial crisis. Over the years between 2003 and 2012, the company's sales have increase by more than 495 times and net profit by more than 336 times (Annual Report 2012). However, the company's website links and its annual report contradicts on sales and net profits for the year 2010, 2011 and 2012.

Chart 3.1: Historical net sales and profit



(Source: Annual Report 2012, 2013).

In 2012, the Group's operating expenses increased (33%), largely due to the growing cost of purchased oil and gas along with taxes. The cost of purchased oil and gas increased by 29%, with gas cost increased by 22% due to higher volumes and prices of gas purchased from third parties outside the Russian Federation (mostly from the Central Asia). Tax expenses were up by RR 36.7bn, largely due to a higher mineral extraction tax rate for gas. Other operating expenses increased mainly due to the exchange rate difference on operating items. The exchange rate difference evolution followed the better performance of the USD and EURO against Russian Rubbles over the analysed period.

In 2012, a RR 7 bn positive impact was achieved on the company in the operating cash flow, which was mostly due to the RR 20bn decrease in gas inventories in UGSFs due to seasonal changes (less gas were put into the storages than taken out).

3.1 Debt Overview

Chart 3.2: Total debt

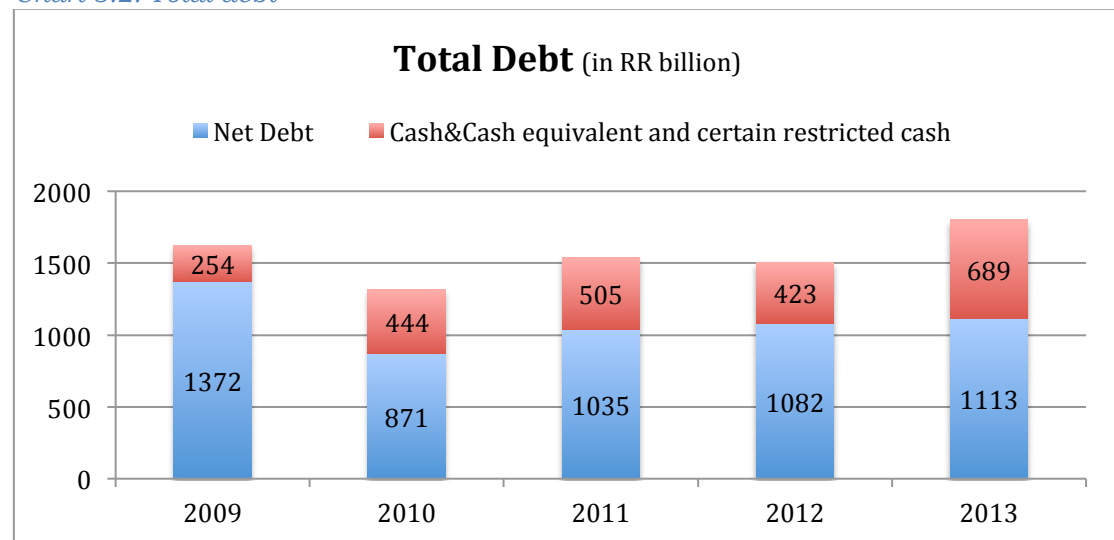


Chart 3.3: Debt maturity profile

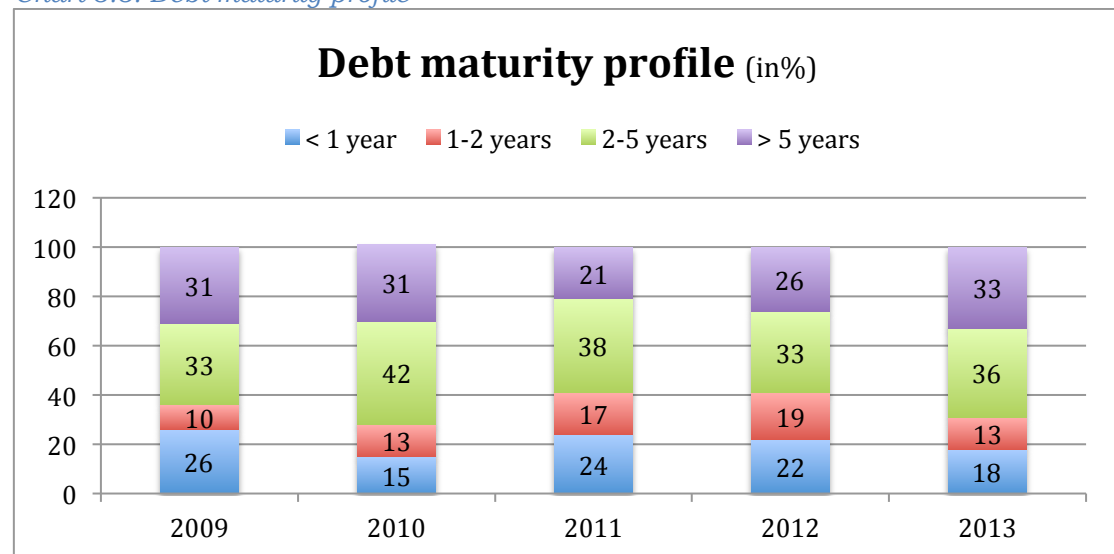
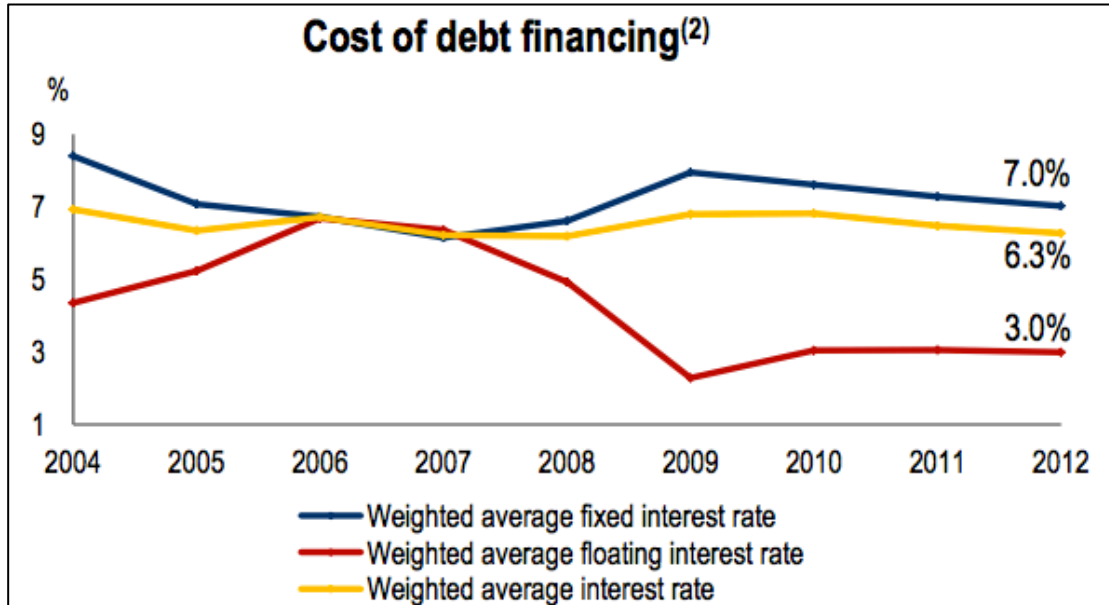


Chart 3.4: Cost of debt financing



The company's big investments for Russia gasification project increased its debt in 2011 and 2012. But the company says it was able to avail debt at the record low rates. The average debt financing rates for the company fluctuates between 6 % and 7 %. The company has increased its capacity to pay off debts in the shorter term. Debt maturity of over 5 years has decreased from 31 % in 2009 to 26 % in 2012. The efficiency would strengthen the ability of the company to get more debt at low rates.

3.2 Balance sheet

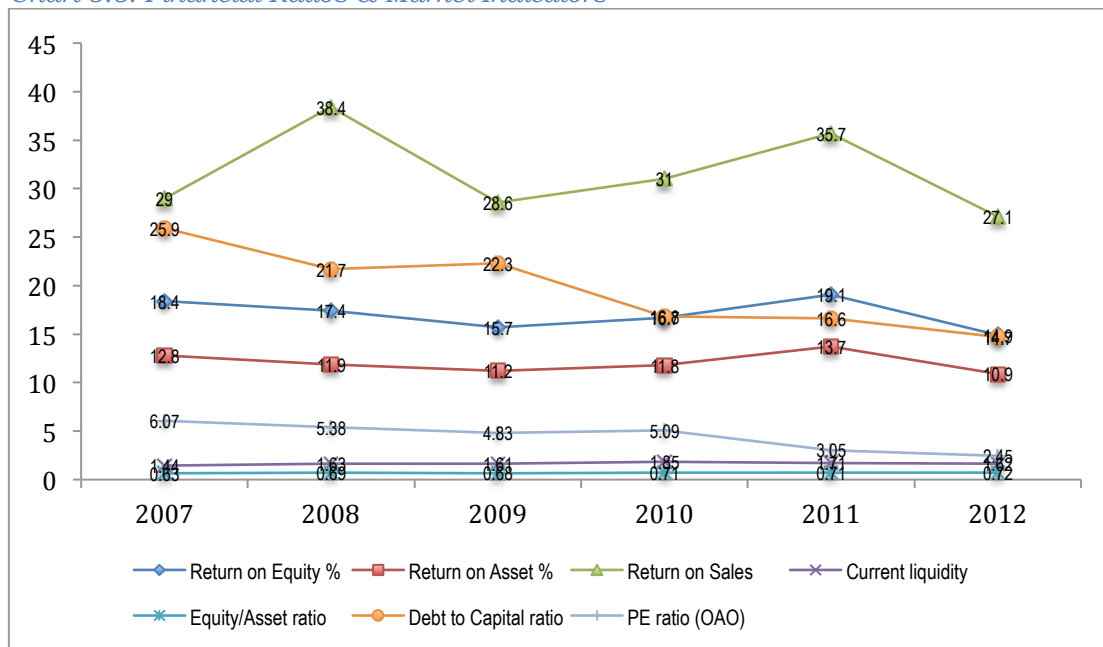
ОАО ГАЗПРОМ
IFRS CONSOLIDATED BALANCE SHEET AS OF 31 DECEMBER 2012
(In millions of Russian Roubles)

Notes		31 December	
		2012	2011
Assets			
Current assets			
8	Cash and cash equivalents	419,536	501,344
8	Restricted cash	3,658	3,877
9	Short-term financial assets	16,962	23,991
10	Accounts receivable and prepayments	940,106	784,053
11	Inventories	459,534	407,530
	VAT recoverable	395,250	303,454
	Other current assets	<u>173,700</u>	<u>216,044</u>
		2,408,746	2,240,293
Non-current assets			
12	Property, plant and equipment	7,818,392	6,718,575
13	Investments in associated undertakings and jointly controlled entities	653,187	715,966
14	Long-term accounts receivable and prepayments	491,018	517,097
15	Available-for-sale long-term financial assets	161,701	181,138
16	Other non-current assets	<u>535,095</u>	<u>527,627</u>
		<u>9,659,393</u>	<u>8,660,403</u>
	Total assets	12,068,139	10,900,696
Liabilities and equity			
Current liabilities			
17	Accounts payable and accrued charges	1,040,274	804,644
	Current profit tax payable	7,463	44,036
18	Other taxes payable	115,273	93,707
19	Short-term borrowings, promissory notes and current portion of long-term borrowings	<u>326,807</u>	<u>366,868</u>
		1,489,817	1,309,255
Non-current liabilities			
20	Long-term borrowings	1,177,934	1,173,294
23	Provisions for liabilities and charges	243,506	206,734
21	Deferred tax liabilities	429,305	402,728
	Other non-current liabilities	<u>26,483</u>	<u>47,694</u>
		<u>1,877,228</u>	<u>1,830,450</u>
	Total liabilities	3,367,045	3,139,705
Equity			
24	Share capital	325,194	325,194
24	Treasury shares	(104,094)	(104,605)
24	Retained earnings and other reserves	<u>8,170,631</u>	<u>7,242,982</u>
		8,391,731	7,463,571
32	Non-controlling interest	<u>309,363</u>	<u>297,420</u>
	Total equity	8,701,094	7,760,991
	Total liabilities and equity	12,068,139	10,900,696

The current asset is increased by 7.5%, non-current asset increased by 11.5 % and in average company's assets is increased by 10.7% in 2012 compared to the previous year.

Current liabilities increased by 13.8%, non-current liabilities increased by 2.5% and in average the liabilities increased by 7.2% in the reported period. The equity increased by 12.1% over the year.

Chart 3.5: Financial Ratios & Market Indicators



(Source: <http://www.gazprom.com/investors/stock/stocks/>)

3.3 Income Statement

ОАО ГАЗПРОМ
IFRS CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2012
(In millions of Russian Roubles)

Notes		Year ended 31 December	
		2012	2011
25	Sales	4,764,411	4,637,090
	Net gain from trading activity	2,821	2,791
26	Operating expenses	(3,481,264)	(2,942,181)
26	Reversal of (charge for) impairment and other provisions, net	<u>3,208</u>	<u>(40,857)</u>
	Operating profit	1,289,176	1,656,843
27	Finance income	307,871	190,488
27	Finance expense	(247,138)	(267,823)
13	Share of net income of associated undertakings and jointly controlled entities	161,500	99,049
	Gains on disposal of available-for-sale financial assets	<u>546</u>	<u>1,379</u>
	Profit before profit tax	1,511,955	1,679,936
	Current profit tax expense	(276,045)	(279,216)
	Deferred profit tax expense	<u>(25,344)</u>	<u>(58,278)</u>
21	Profit tax expense	(301,389)	(337,494)
	Profit for the year	1,210,566	1,342,442
	Other comprehensive income		
	Losses arising from change in fair value of available-for-sale financial assets, net of tax	(17,499)	(7,669)
	Share of other comprehensive gain (loss) of associated undertakings and jointly controlled entities	1,885	(19,302)
	Translation differences	(32,366)	19,342
	Gains from cash flow hedges, net of tax	<u>806</u>	<u>-</u>
	Other comprehensive loss for the year, net of tax	(47,174)	(7,629)
	Total comprehensive income for the year	1,163,392	1,334,813
	Profit attributable to:		
	owners of ОАО Gazprom	1,182,625	1,307,018
32	non-controlling interest	<u>27,941</u>	<u>35,424</u>
		1,210,566	1,342,442
	Total comprehensive income attributable to:		
	owners of ОАО Gazprom	1,137,257	1,297,891
	non-controlling interest	<u>26,135</u>	<u>36,922</u>
		1,163,392	1,334,813
29	Basic and diluted earnings per share for profit attributable to the owners of ОАО Gazprom (in Roubles)	51.53	56.95

Despite increase in sales revenue in 2012 compared to 2011, company's operating profit for 2012 has decreased during the increased operating expenses due to increased expenses on infrastructure expansion. Consequently profit and earnings per share has also decreased.

3.4 Statement of Cash Flow

GAO GAZPROM
IFRS CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2012
(In millions of Russian Rubles)

Notes	Year ended 31 December	
	2012	2011
	Operating activities	
30	Net cash provided by operating activities	1,445,617
	Investing activities	
12	Capital expenditures	(1,339,878)
	Net change in loans issued	(5,566)
	Interest received	24,379
12	Interest paid and capitalised	(66,873)
33,34,36	Acquisition of subsidiaries, net of cash acquired	(55,810)
13	Investment in associated undertakings and jointly controlled entities	(15,063)
	Proceeds from sales of interest in subsidiaries	-
13	Proceeds from associated undertakings and jointly controlled entities	189,692
	Net change of long-term available-for-sale financial assets	(1,141)
	Change in other long-term financial assets	2,950
	Net cash used for investing activities	(1,267,310)
	Financing activities	
20	Proceeds from long-term borrowings	236,130
20	Repayment of long-term borrowings (including current portion)	(259,653)
	Net repayment of promissory notes	(2)
19	Net repayment of short-term borrowings	(2,831)
24	Dividends paid	(197,037)
	Interest paid	(26,718)
24	Sales (purchases) of treasury shares	511
	Change in restricted cash	219
	Net cash (used for) provided by financing activities	(249,381)
	Effect of exchange rate changes on cash and cash equivalents	(10,734)
	(Decrease) increase in cash and cash equivalents	(81,808)
	Cash and cash equivalents, at the beginning of the reporting year	501,344
	Cash and cash equivalents, at the end of the reporting year	419,536

The cash flow has decreased by big amount in 2012 compared to 2011. In 2011 the company had positive cash flow of RR 60 billion but in 2012 the company's net cash flow decreased by RR 81 billion despite the fact that Gazprom decreased its investments in 2012 compared to the previous year. The company also made losses from financing activities and currency exchange rates primarily due to appreciating rubbles.

4. Key Success factors

4.1 Gas/petro products demand in European countries

Europe, including all EU members plus Turkey, Norway, Switzerland, and the non-EU Balkan states, consumed 18.7 trillion cubic feet (Tcf)

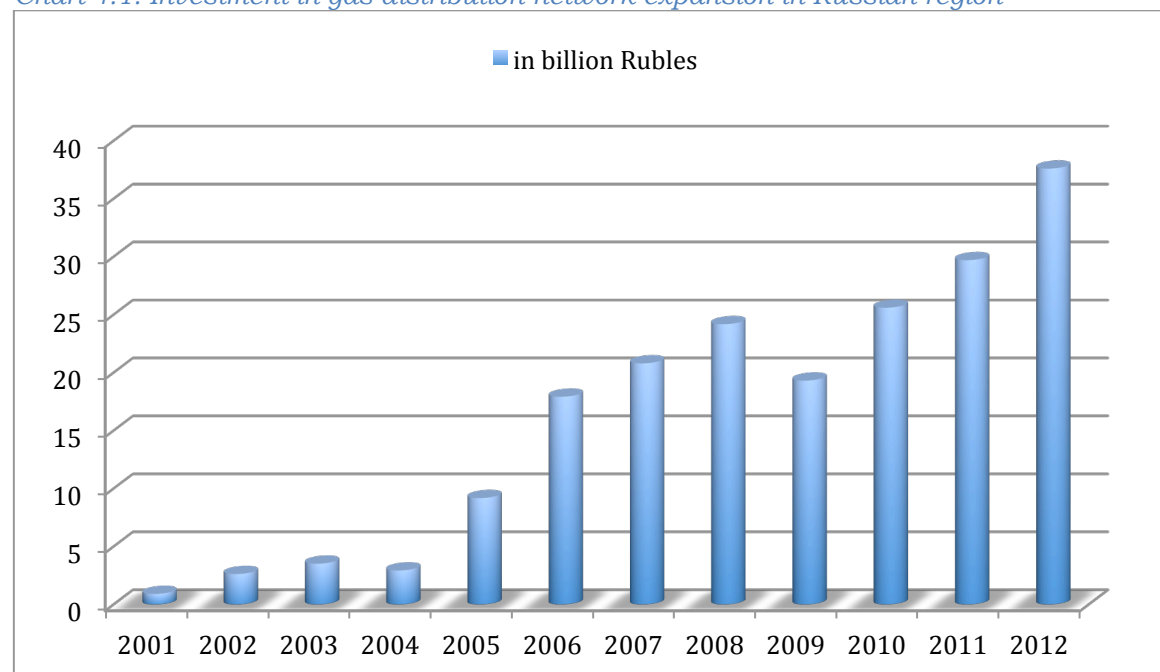
of natural gas in 2013. Russia supplied 30% (5.7 Tcf) of this volume (The Energy Collective, 2014).

The Balkan countries have also increased their reliance with Russia for supply of natural gas. The 10 countries of the region in 2007 agreed for more investment in infrastructure by Russia in the region for better supply of gas. (International Relations and Security Network, 2007)

The increase demands for cleaner energy such as natural gas from Europe provided opportunities for Gazprom to expand its business empire. In many former Soviet Union states, the company provided gas in subsidised rates making them dependent on Russia. In short run, this would not be beneficial for Russia but in long run, it would make those countries more dependent on Russia than seeking any other alternatives.

To meet this demand, the company has invested heavily to build a strong distribution network in the region. In 2011 Gazprom invested over 29bn rubles (Approximately AU\$870 million) in expanding gas supplies to Russian regions, a 16% rise compared to 2010. In 2012 the Program funding increased considerably, reaching over 37.6bn rubles (approximately AU\$1.13 billion. (Sustainability Report 2010-11, p108)

Chart 4.1: Investment in gas distribution network expansion in Russian region



4.2 Human resource management

As of December 31, 2012 Gazprom Group employed a total of 431,200 people. Gazprom's staff is characterized by high stability. For instance, in 2011 the staff turnover in subsidiary companies engaged in gas production, transportation, processing and storage was only about 2 % (Gazprom Press Release June 2013)

The expanding business empire means greater employment opportunities. Gazprom created 25,800 employment opportunities in 2012. The company is more stable than any other big companies in Russia. This is better than the best 100 US companies based on employee turnover published by CNN in 2012. (CNN Money, 2012)

The company's has strong motivational and employee retaining policy. The government ownership and job guarantee could be the possible, but not alone, reason for low turnover in the company. The company human resource policy states:

Gazprom Group's employee motivation system, combining financial and non-financial incentives, is aimed at attracting and retaining qualified personnel, as well as increasing the employees' commitment to high performance.

The wage systems of Gazprom Group subsidiaries provide that the position salaries and tariff rates be determined by qualification and business qualities, running rewards – by the employees' production activity; additional payments and increments depend on labor conditions and amount of work performed, non-recurrent rewards (including rewards for production facilities and construction objects commissioning, new equipment introduction, energy resources saving, new hydrocarbon deposits discovery) and reward payments according to work results (Gazprom 2003-2014)

4.3 Social engagement

Gazprom is closer to communities as well, fulfilling its Corporate Social Responsibilities (CSR). Projects under CSR in communities build public loyalty towards the company making positive impact on the businesses. The company involves both local communities and the Company's employees in the process of shaping the portfolio of projects, and in directly implementing social programs (Gazprom Neft, 2012, p7).

A few other instances of CSR projects by Gazprom are:

- Supporting indigenous minorities by investing in development infrastructures in the regions where indigenous minorities live.
- Gazprom Dobycha Urengoy takes comprehensive measures to protect the human environment and traditional life style of

indigenous minorities of the North. (Sustainability Report 2010-2011)

4.4 Investment in R&D

The company also values investment in research and development. R&D is necessary part of this company because it is in expanding phase, which requires greater knowledge of markers, exploration sites, marketing techniques, competitors and design strategies to differentiate itself from other companies. Gazprom is the R&D leader among Russian energy companies and is among the top ten global energy companies. In 2011 Gazprom invested approximately 7.9bn rubles (approximately AU\$ 237 million) in R&D, up 11 percent compared to 2010. (Sustainability Report 2011 p102)

5. SWOT Analysis

5.1 Strength

1. Huge production
2. Market position
3. Talent training
4. Customer occupancy volume
5. Specialist

Huge production

Gazprom produces 8% of the value of gross domestic product in Russia and shares 25 percent to the total Russian budget. The company controls 74% of Russia and 18% of world's gas reserves. The gas supply is through Unified Gas Supply system – the largest gas pipeline network in the world expanding over 158,000 km.

Market position

Gazprom occupies 25% of the Europe's natural gas market. Gazprom contracts out to other company for gas supply such Petrovietnam Oil and Gas Group from Vietnam, SOCAR from Georgia, Gasunie from Netherlands and Siemens from German. They have notable presence in American and Asian markets as well.

Talent training

Gazprom has an impeccable system to train their staff. They design personal training plans aimed at grooming them individually. Gazprom targets to transform every individual employee into expert and leader and regard middle level manager as important personnel who bring benefits to the company.

Customer occupancy volume

Their big operating margin is the result of voluminous customer base. 25% of the European population depends on Gazprom for gas supply. The situation is unlikely to change in near because Gazprom has an impeccable pipeline to supply gas to Europe and the import cost is cheaper than other firms.

Specialist

Gazprom concentrated its focus on gas products and developed its competitive skills and extensive knowledge on the industry.

5.2 Weakness

1. Limited by government control
2. Debt problems
3. Quality questioned

Limited by government control

The Russian federal government controls the company. Many of the business decisions taken by the company are directly influenced or directed from the government. The company is losing business in countries having differences with the Russian government.

Debt problems

Increasing debt is cause of concern for the company. The net debt is on continuous rise for last four years. As of 2013, the company's net debt stands at RR 1113 billion (US\$ 31.7 billion). Though short-term debts are decreasing, long-term debts are on rise. It is not a big weakness but may prove to be so if not given care of.

Quality questioned

Gazprom in Armenia faces allegations that the gas it supplied is of poor quality. The company allegedly mixes nitrogen into methane gas. One such incident in Ukraine had reached court and the test by Ukraine's National Academy of Sciences proved the gas was of poor quality. (Epress.com, 2014).

5.3 Opportunities

1. Optimize current market
2. More global market
3. Efficient technology

4. Consumer services
5. Privatization

Optimize current market

Gazprom has an unending construction of pipeline that will help them in finding new resources and new markets. If they find some new resources, the pipeline can also bring them competitive advantage on transportation and supply side. The rapid growth in Europe is demanding for more energy and it is a golden chance for them in increasing their growth in this industry.

More global market

The company is already signed agreement to expand the market into China. India, Indonesia and other South and South East Asian nations would be the big market for the company to consider. Additionally, Latin American countries like Brazil, Mexico, Colombia, Argentina and Venezuela would be the potential market for the company.

Efficient technology

The company has the opportunity to invest more on efficient technology development. It invests a huge amount on R&D and if these investments are set aside for technological development, the company would enhance its productivity.

Consumer services

A big chunk of population in Asia and Europe depend on Gazprom for gas supply. There are glitches and allegations of poor quality products being supplied to them. The company has opportunity to keep these loyal customers by improving the consumer services.

Privatization

Being controlled by government and politically influenced means the company has to forego many business opportunities in favour of political gambling. Currently little less than 50 percent of the company is owned by private entities. The Russian government has indicated the possibility of making the company a completely private entity in future but only when internal and external gas prices have been brought to a par with each other (Voice of Russia, 2013). IF it goes as said, it would open new horizon for the Gazprom to do business.

5.4 Threats

1. Insufficient information
2. Geopolitical situation
3. Technology development

Insufficient information

The company's information are carefully controlled, many believe. This would have negative impact on the company's prospects of getting more investors.

Geopolitical situation

Georgia and Ukraine are two litmus tests for Gazprom how geopolitics can affect their business. Under government pressure, Gazprom stopped any forms of discount given to Ukraine in gas. This political turmoil and Europe's difference with Russia would put further pressure on the Gazprom and possibility of losing the market would rise.

Technology development

Lagging behind technological development would hamper the company's competitive advantage and affect productivity.

6. TOWS Matrix

6.1 SO Strategies

S1S2O2. Gazprom has a strong competitiveness in the global market. Those huge occupancy volumes can take Gazprom enough market share and position in the global market. Based on their market position, Gazprom can take more market in Asian and South America.

S3O3. This system can help Gazprom recruit and retain expertise. More emerging technology talents would find Gazprom an attract company to work with, eventually helping Gazprom improve its efficiency and productivity.

S4O4. Large customer occupancy volume and better customer services would support the Gazprom's mission to expand more market.

6.2 ST Strategies

S3T3. Gazprom must invest in training its employees on advance technologies and create environment to attract new technology scientists into its expert circle to make research on newer technologies.

S4T2. The company has such a big customer volume that it could be easily swayed by the geopolitical circumstances. The company must remain out of political give and take and concentrate purely on business.

6.3 WO Strategies

W1O5. The faster Gazprom realize 100% privatization, better is its business prospects. Coming out of political circle could open more markets and improve customer confidence.

W3O2O4. The company should develop their quality and customer services to strengthen the relationship with customers. Improving trust is the most important factor to stabilize their market position.

6.4 WT Strategies

W1T2. Gazprom should break away from the Russia government control and expand business in areas where it was not possible while under the government.

W3T1T3. Invest more on technology and ensure questions on quality are addressed. The company must release more information so the consumers would be able to verify if the allegations are true.

7. Recommendations

The company is concentrated to Asian and European markets. Until third week of May 2014????, when China and Russia signed gas deal worth \$400 billion, Gazprom has very little penetration into big Asian markets. It still hasn't reached out to other big markets like India, Indonesia and other heavily populated countries. There are also opportunities for Gazprom to expand to countries like Brazil, Argentina in to boost Latin American markets.

The company is heavily politically influenced. Continued political influence would not be beneficial for the business. It is recommended to keep away from politics.

There are increasing demands and urge more renewal energy like winds and solar. Gazprom could benefit from investing in these sources

WWF has accused Gazprom for not being environmentally responsible company. A report by WWF says, the company has double standards in protecting environment. In Russia, a number of Gazprom projects are characterized by information secrecy, noncooperation with NGOs and even direct violations of the Russian law and international obligations. Gazprom is recommended to improve technology to reduce impact on environment that would also help the company to enhance productivity.

Eastern Europe is not a stable market anymore. Political debacle directly affects the business of the company. It is advisable for the company to see for politically stable markets such as China, Mongolia and ASEAN countries.

There are too many subsidiaries, which might in future difficult to manage. The reduction in number of subsidiaries could reduce the operational costs of the company.

End of gas subsidies given to former Soviet Union nations would greatly improve the financial situation of the company. Many countries have not been able to pay back even the bills of subsidized gas.

Additionally, outsourcing would provide opportunities to reduce the cost and increase profits. The company through outsourcing could acquire raw materials than producing through its subsidiaries.

References

100 Best companies to work for, CNN Money, US, viewed 25 April 2014, <<http://money.cnn.com/magazines/fortune/best-companies/2012/turnover/>>

16% of Natural Gas Consumed in Europe Flows Through Ukraine, The Energy Collective, 15 March 2014, viewed 15 April 2014 <<http://theenergycollective.com/todayinenergy/354301/16-natural-gas-consumed-europe-flows-through-ukraine>>

Gas and oil reserves, n.d, Gazprom, Russia, viewed 1 May 2014, <<http://www.gazprom.com/about/production/reserves/>>

Gazprom Armenia Deceives Consumers, Offers Low-Quality Gas: Opinion, EPress.com, 11 February 2014, Independent Journalist Network, Armenia, viewed on 27 May, 2014, <<http://www.epress.am/en/2014/02/11/gazprom-armenia-deceives-consumers-offers-low-quality-gas-opinion.html>>

Gazprom in figures 2006-2010: Factbook, n.d, OAO Gazpprom, Russia, viewed 2 May 2014, <<http://www.gazprom.com/f/posts/57/370859/gazprom-reference-figures-2006-2010-en.pdf>>

Gazprom opens doors to foreigners, BBC, 24 June 2005, viewed 22 April 2014, <<http://news.bbc.co.uk/2/hi/business/4618163.stm>>

Gazprom Press Release, Personnel is Gazprom's competitive advantage in global energy market, Information Directorate, OAO Gazprom, 18 June 2013, viewed 16 April 2014 <<http://www.gazprom.com/press/news/2013/june/article164707>>

Gazprom privatization possible only when foreign, domestic gas prices even- Putin, The voice of Russia, 19 December 2013, Moscow, viewed on 27 May 2014,

<http://voiceofrussia.com/news/2013_12_19/Gazprom-privatization-possible-only-when-foreign-domestic-gas-prices-even-Putin-5470/>

Gazprom Should Keep Pipeline Monopoly, Minister Says (Update1), Bloomberg Businessweek, 14 March 2006, viewed 20 April 2014, <<http://www.businessweek.com/news/2006-03-14/gazprom-should-keep-pipeline-monopoly-minister-says-update1>>

IFRS consolidated financial statements, 31 December 2012, OAO Gazprom, Russia, viewed 10 May 2014,

<<http://www.gazprom.com/f/posts/01/207595/gazprom-ifrs-12m-2012-en.pdf>>

Ivannikov, Alexander, *2012 IFRS Consolidated Financial Results*, 30 April 2013, Gazprom, viewed 7 May 2014
<<http://www.gazprom.com/f/posts/01/207595/gazprom-12m-2012-ifrs-presentation.pdf>>

Management's discussion and analysis of financial condition and results of operations, Management discussion paper, n.d, Gazprom, Russia viewed on 5 May 2014
<<http://www.gazprom.com/f/posts/01/207595/gazprom-ifrs-management-report-9m2012-en.pdf>>

Moscow turns its attention to the Balkans, International Relations and Security Network (ISN), 28 June 2007, viewed 15 April 2014,
<<http://www.isn.ethz.ch/Digital-Library/Articles/Detail/?lng=en&id=53426>>

Personnel management policy, OAO Gazprom 2003-2014, viewed 27 April 2014, <<http://www.gazprom.com/careers/hr-policy/>>

Russia signs 30-year gas deal with China, BBC News, 21 May 2014, viewed 21 May 2014, <<http://www.bbc.com/news/business-27503017>>

Russia writes off 90 percent of North Korea debt, eyes gas pipeline, Reuters, April 2014, viewed 15 April 2014
<<http://uk.reuters.com/article/2014/04/19/russia-northkorea-debt-idUKL6N0NB04L20140419>>

Russia's Duma gives nod to Gazprom export monopoly law, ICIS, 16 June 2006, viewed 15 April 2014,
<<http://www.icis.com/heren/articles/2006/06/16/9288194/russias-duma-gives-nod-to-gazprom-export-monopoly-law.html>>

Sustainability Report 2010-2011, OAO Gazprom, viewed 25 April 2014, <<http://www.gazprom.com/f/posts/64/119881/sustainability-report-2011-en.pdf>>

Sustainable Development Report 2012, Gazprom Neft, viewed 26 April 2014 <http://www.gazprom-neft.com/annual-reports/2012/Gazprom-Neft_CSR_Report_2012_eng.pdf>

Transmission: Unified Gas Supply System of Russia, n.d, Gazprom, Russia, viewed 1 May 2014,
<<http://www.gazprom.com/about/production/transportation/>>

WWF compares Nord Stream with other Gazprom projects, World Wildlife Fund, Russia, 8 November 2011, viewed 22 May 2014
<<http://www.wwf.ru/resources/news/article/eng/8875>>