

Gazprom Recapitalization Harbors Risk

By [The Moscow Times](#)

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President Vladimir Putin's idea of a massive boost to Gazprom's share capital has taken bankers and the energy industry by surprise, with some fearing it could further strain Russia's sanctions-hit economy and undermine the ruble.

Putin floated the unexpected suggestion on Wednesday, hinting that a recapitalization of the state gas giant could be funded from Russia's gold and foreign currency reserves. Since then, sources have suggested the money could come from a "rainy day" fund meant to cover the state pension deficit.

But the Kremlin has declined to elaborate on the plan, and analysts are questioning not only how it would be implemented, but whether Gazprom actually needs the extra funds at all.

"The Gazprom story is ruble-negative. The use of forex reserves to recapitalize Gazprom will decrease the safety cushion held by the Central Bank," said Tatyana Orlova, a strategist at RBS in London.

Russia's gold and forex reserves, the world's fourth-largest, have shrunk by \$42 billion since last year to \$466.9 billion, mostly due to the Central Bank's efforts to curb the ruble's fall since the crisis over Ukraine erupted.

"Reserves are needed to support the ruble. We should not forget about 2008 when oil prices more than halved. ... I think this is a very tricky path," said Sergei Zhavoronkov of the Moscow-based Gaidar Institute for Economic Policy.

During the 2008 global financial crisis, Russia hemorrhaged about \$200 billion, or a third of its reserves, to prop up the currency.

Following a landmark \$400 billion agreement last month to sell natural gas to China, officials estimate Gazprom now needs some \$55 billion to build pipelines and bring two giant fields — Kovykta and Chayanda — on stream.

It was against that background that Putin told an energy industry conference that a recapitalization could help Gazprom pay for the required infrastructure.

"It came as a total surprise to us," said an aide to one of the participants at the meeting.

Very Hard Year

Hit by Ukraine-related sanctions that have triggered nearly \$70 billion in capital outflows so far this year, the economy is expected to grow only by around 0.5 percent in 2014, compared to an initial government forecast of 2.5 percent.

The ruble is 5 percent down since the start of the year against the dollar. Even after rebounding from a steep fall when Russia annexed Ukraine's Crimean peninsula in March, it is still underperforming compared to other currencies in the BRICS group of developing nations.

The leaders of Russia and Ukraine met on Friday for the first time since Moscow annexed Crimea, even as fighting continued in eastern Ukraine between government forces and pro-Russian separatists.

"This crisis is much worse than in 2008. At that time, everyone was in the same boat. Now it is only Russia, and everyone wants to sink it in addition to dealing with their own problems," said a senior banker from a Russian state-owned bank.

"It will be a very hard year."

Ukraine-related volatility has brought a spike in borrowing costs for Russian companies, leaving the domestic market or the government to serve all the needs of Russia's \$2 trillion economy unless Moscow can raise funds in Asia.

Analysts, business and government sources asked by Reuters about the Gazprom idea said a recapitalization could be carried out via loans from state entities or by government purchases of new shares. But under current law, the Central Bank cannot invest its reserves in equity.

Several sources told Reuters the cash could come from one of Russia's rainy day funds that have amassed windfall oil revenue.

"There is an understanding that either the Reserve Fund or the National Welfare Fund" will be used, said a government source. Both are managed by the Finance Ministry and their foreign currency holdings are part of the Central Bank's reserves.

But by law, the Reserve Fund can only be used to cover budget deficit or repay national debt — so unless there is a change in legislature, the Welfare Fund seems the more likely option. As of June 1, the fund stood at \$87 billion, or 4 percent of Russia's gross domestic product.

The fund, which would have little left if Gazprom received all \$55 billion, is essential to finance the Pension Fund deficit, which came to \$27 billion last year. The need for state support is expected only to grow as Russia's 143-million population is aging, and 40 million are pensioners already.

Lack Of Detail

Ksenia Yudayeva, first deputy governor at the Central Bank, declined to comment on the recapitalization plan when approached at a conference in London on Thursday. Gazprom and the Energy Ministry also declined to comment, while the Finance Ministry would not return calls.

Kremlin spokesman Dmitry Peskov, asked to explain Putin's remarks, told Reuters the issue needed to be discussed further.

Rosneft boss Igor Sechin, viewed as the most powerful Russian energy executive, told reporters on Thursday that Gazprom's recapitalization is "a rational and very right idea," and that Rosneft might take part in the process.

"There was a talk of possible pension money, reserves," he said. "We will look into it if we are asked to. But I think it is better to use those sources."

The idea also won support from Yevgeny Gavrilenkov, economist at state-run Sberbank, who said the Gazprom money was a political price Russia needed to pay.

"Looking at geopolitics, sanctions, the supportive message is needed that there is this money, and in reality, it is there," he said.

Financial Strenght

Other analysts, however, pointed to the relative low debt of Gazprom, a company often referred to as Russia's "national heritage," and the lack of apparent obstacles to raise new debt.

Furthermore, Russia and China have agreed in principle that Beijing will make a \$25 billion prepayment under their gas deal, according to Alexander Medvedev, chief executive of Gazprom Export, which could be used for new infrastructure.

"Gazprom could manage without recapitalization," said Ivan Mazalov, a director

at Prosperity Capital Management, a Gazprom shareholder. "There are no grounds for share issue. They have good cash flow and debt is at adequate level."

A banking source told Reuters that Gazprom may do a "small" borrowing operation in Chinese yuan this autumn to test Asian appetite for possible bigger deals.

"It has \$20 billion of cash and cash equivalents on its balance sheet, generates \$55 billion in operating cash flow and has a 0.9 debt/EBITDA ratio. So the company has enough cash to finance its Eastern program, we believe," VTB Capital said in a note.

Amid the doubts, confusion and lack of further detail from the government, Merrill Lynch analysts suggested the whole idea may be quietly buried.

In a note, they said: "We spoke to Gazprom, who said they are confident this initiative gets forgotten about quickly."

See also:

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