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Ukraine: a record year for Naftogaz

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On 3 February, the Ukrainian state company Naftogaz published its data for 2016. For the first time in its independent history, Ukraine did not buy any gas directly from Russia, thus reducing its imports by about 32%, and relying entirely on supplies from Europe (11.1 bcm) and domestic extraction (20.1 bcm). In this period, the company also pumped the least amount into its underground storage (6.4 bcm) from which gas is used to support transit from Russia to the EU, and for internal use. Also for the first time, Naftogaz will end last year more than $1 billion in profit, which will allow it to become a net contributor to the state budget. Reforms within the company were also continued.

Commentary

- Naftogaz has not bought any gas directly from Gazprom for several reasons. First, the drop in demand in Ukraine: in 2016, domestic consumption decreased by 2% to 33.2 bcm, primarily due to a reduction of 12% in consumption by the industrial sector. Secondly, the lack of agreement between Naftogaz and Gazprom on extending the so-called winter package, under which Ukraine has been buying gas from Russia while bypassing the 'take or pay' clause. Third**,** the availability of gas and the favourable price trends on European markets; Naftogaz's savings resulting from purchases of gas from the West, and not from Gazprom, are estimated by the company at US$400 million, although the real amount is probably only a quarter of this figure.
- Ukraine has entered the 2016/2017 heating season with its underground gas storage at record low levels: 14.7 bcm, compared to 17 bcm in 2015. However, despite lower temperatures than last year, the rate of withdrawal from the tanks is also lower now, because import levels from the West, mainly Slovakia, are being kept close to the maximum. As of 5 February, the reservoirs hold 9.5 bcm, which with an average daily withdrawal rate in recent weeks of 70 mcm, and daily imports remaining at around 45 mcm on average, should allow Ukraine to get through the heating season, unless unforeseen circumstances arise.
- Naftogaz made a profit for the first three quarters of 2016 thanks to the greater transit of Russian gas to the EU than in 2015 (an annual increase of 23%, to 82.2 bcm); this generated 78% of the company's income. Naftogaz owes its remaining profit to gas sales on the domestic market at a higher and unified price. In addition, the company's results were affected by the relatively low price of gas on the European markets, as well as a system of subsidies introduced by the government for the households, which limits

losses to the suppliers arising from non-payment by customers. 2016 also saw the first steps to the ownership unbundling of Naftogaz. On 1 July, the Ukrainian government approved a restructuring plan for the company, providing for the removal from its structure of transit gas pipelines and underground gas storage facilities. However, the dispute between Naftogaz's management and the government, as well as the judgement from the Court of Arbitration in Stockholm in the trial with Gazprom concerning the conditions of Naftogaz's gas purchases in the past (which is expected in the spring), will push back the unbundling process to a later date.