
LIBERALIZATION!

NEW CHALLENGES FOR GAZPROM!

Dear shareholders, colleagues, partners!

Allow me, on behalf of the Board of Directors and Management Committee of Open Joint-Stock Company Gazprom, to express my personal greetings to you on the occasion of the Company's Shareholders' Meeting.

The year 2004 has become another period of record high achievements for Gazprom. The Company is keeping a steady pace towards expansion, with substantial measures stepped up for the conversion into a world-class energy firm.

The decision to increase the state's share in Gazprom was undoubtedly last year's watershed for the Company. Yesterday, we executed the deals on purchase & sales of the 10.74% corporate stake. In compliance with the agreements sealed between Gazprom's subsidiaries and state-owned Rosneftgaz, the shares will be fully paid up until this year-end.

Boosting the government's share in Gazprom's authorized capital to a controlling stake marks the initiation of the Company's share market liberalization, which represents a natural and logic step towards a must-be structure of Gazprom's share market.

Gazprom's shares will be available to an each time wider pool of investors and the share capital structure will become more transparent, with the controlling stake owned by the state and the rest, by private investors.

Deeper interrelationship between Gazprom and the Russian Government will open new horizons for mutually beneficially fulfillment of strategic tasks.

The liberalization will enable us to calculate a reasonable value of Gazprom's shares, realize their huge potential and contribute to meeting Gazprom's strategic challenge of achieving the long-term corporate value growth.

Dear stockholders!

Sufficient resources are a key factor for any oil & gas company in terms of long-term value growth.

Gazprom's share in the global and Russian explored gas reserves accounts for 16% and 60%, respectively.

As of year-end 2004, the Company's proved hydrocarbon reserves were valued, in accordance with the Russian assessment standards, in the following way:

- Gas – 28.9 tcm;
- Condensate – 1.22 bln t;
- Oil – 0.65 bln t.

For a comparison, the Near East countries counting on the bulk of the global proved gas reserves are behind Gazprom in terms of the aforementioned parameters.

The current proved reserve figures are pointing to the fact that we're far ahead of the top five global petroleum companies all together.

The Gazprom's Program of measures aiming to develop the natural resource base has been scheduled until 2030. We've succeeded in improving the situation in regards with the replenishment of reserves, as compared with the 1990s. Based on the geological exploration achievements over 2004, gas reserves have exceeded 378 bcm, with the reserve replenishment coefficient growing more than twofold since 2001. In the nearest future, we'll reach equilibrium between gas reserve extraction and growth and we'll get to the expanded exploitation of natural resources starting 2011.

Furthermore, Gazprom's gas resources can be identified as inexhaustible in a reasonable historical perspective, given the additional onshore and offshore prospecting for coal-bed methane and gas hydrates. This is a strategic and competitive advantage of Russia over a plenty of other traditional gas production provinces, North Europe, for instance.

The Company's *production potential* is also a substantial factor for its stock-market value assessment.

Speaking of the production potential of Gazprom, I'd like to emphasize that gas production was undergoing sustainable growth over 2004, with 545.1 bcm extracted, which is 4.9 bcm and 3.1 bcm up on the 2003 production rates and 2004 target.

In 2004, Gazprom commissioned the Yety-Purovskoye gas field, Pestsovaya area of the Urengoyenskoye gas condensate & Aneryakhinskaya area of the Yamburgskoye fields and brought the Zapolyarnoye field to its nominal capacity, increasing, thus, new gas extraction capacities by some 60 bcm over 2004 only.

Over the past four years, we've managed to bring on-line the gas production infrastructure with 184.5 bcm/y in overall design capacity, which will last us over a mid-term perspective. This achievement will allow us to lay larger emphasis on the gas transmission network debottlenecking.

The required gas production levels will be achieved till 2010 through the commissioning of satellite fields located within short distances from gigantic fields under operation and existing infrastructure. The move predetermines high economic viability of the projects.

To further meet the boosting gas demand both in Russia and abroad, Gazprom intends to promote new gas extraction provinces including the Yamal Peninsula and adjoining offshore, Arctic shelf, Eastern Siberia and the Far East.

I can reassure you that the gas quotas allocated over a long term are fully secured by the resources available.

It is also worth mentioning that the growth of our production rates intensifies gas transmission activities, making the gas transmission network overloaded!

Within 2004, the United Gas Transmission System (UGTS) piped 687.4 bcm of gas, with 33 independent gas suppliers gaining access and transporting 100 bcm of gas, 4.5% bcm up from 2003. Gazprom also provided transmission of 43.6 bcm of gas from Central Asia.

Given the boosting gas production by Gazprom, UGTS was close to reaching its technical capacity limits by 2004. UGTS' service life is almost half-century old, with 17% of pipelines more than 35 years old, another 41% roughly the same age, 31% built 10-20 years ago and only 11%, within the 10-year bracket. Substantial investments are needed to maintain UGTS and adapt it to growing gas deliveries.

For the purpose of ensuring gas transmission in the required amount, Gazprom has been implementing since 2002 a comprehensive Program for the existing infrastructure debottlenecking. Higher reliability of the gas transmission network has been identified as a priority investment business, with capital injections accounting for 65% of the total.

Synchronized commissioning of gas transmission & production capacities is among key elements of our strategy, as well. The recent reporting year saw the construction of more than 1,000 km of new lines, including the largest Northern Tyumen Region – Torzhok gas pipeline that would expand the capacity of the northern corridor from the Nadym-Pur-Taz region.

I'd like to specifically underscore that combining a powerful resource base with a unique transmission network creates excellent conditions for a maneuver targeted at the gas supply flexibility. And that is obviously a competitive advantage of Gazprom.

Dear shareholders!

Gazprom's *market positioning* is another factor pointing to the high potential of our corporate value growth.

Unfortunately, it is inappropriate nowadays to speak of a gas market in Russia. There's no gas market in Russia! And we won't have it while we'll keep on endeavoring to retain 'socialism' in the gas industry.

The gas sector is a cash cow for practically all the branches of the national economy, providing cheap gas both to high profitability export-oriented firms and inefficient energy-intensive companies wasting gas for nothing as well as to social consumers badly needing our backing.

Currently, we are not selling but merely distributing gas to Russian consumers at state-regulated prices that do not reflect the value of gas as a commodity and are unfair in relation to coal, fuel oil and other alternative fuels. Without the gas market liberalization, we won't get rid of the well known defects and disadvantages typical to the existing gas distribution system in our country.

Establishing a competitive primary energy market along with a system of long-term gas supply contracts with a pricing formula and promoting spot trading based on stock market technologies is a solution to the problem.

Another substantial challenge is the present-day technical condition of low pressure gas distribution networks channeling gas to end users, the population inclusive. Gazprom has invested substantial funds into the gas consumption intensification but the financing proved to be insufficient due to the breakup between the wholesale gas supply system and the customers.

The existing ownership structure in the gas distribution sector is unable, in our viewpoint, to fit with the actual gas supply safety & security requirements. At present, Gazprom is engaged in the consolidation of gas distribution companies and plans to hold a dominating position on this market. Thus, we're committed to providing the population with reliable gas deliveries and further developing low pressure gas grids. For these purposes, we intend to channel a part of the funds to be received from the Gazprom's stake sales to the state.

Dear shareowners!

Gas deliveries to FSU allow us to retain our positions on local gas markets, with minimum profits derived though. Over 2004, we supplied the CIS and Baltic States with 52.5 bcm of gas. Starting next year, we're determined to raise prices and shift over to purely market-based business mechanisms, excluding non-transparent barter deals and debt cross-cancellation. Nobody in the world is running business in such a way nowadays.

Thus, we should draw a conclusion that gas exports to Europe are the only source of profit for Gazprom today.

In this regards, I can't but mention that Gazprom is confidently retaining the leading position worldwide in terms of natural gas exports. Currently, the share of Russian gas in Europe's consumption and import accounts for 26% and some 40%, respectively. In 2004, we exported a total of 140.5 bcm of gas to outside FSU and 145 bcm is slated for 2005.

Gazprom's export strategy is based on maintaining long term contracts and simultaneous exploitation of additional possibilities using the spot market for export sales. The key element of the corporate export strategy is, and will be in the foreseeable future, the integrated exports sales channel.

In terms of expanding its European market share, Gazprom is increasingly exploiting new forms and methods of trading, such as spot and short term deals, trading hubs, and is developing its own system of underground natural gas storage facilities in Europe. Our goal is to position ourselves as close as possible to the European consumers of natural gas.

Since 1999, Gazprom has been involved in short term natural gas trading in the Great Britain actively increasing its supply in this market. In 2003, 2.1 bcm of natural gas was supplied to the Great Britain, and, in 2004, the supply increased to 4 bcm of natural gas. The British natural gas import potential is quite impressive, and is set to amount to tens of billions cubic meters by the year 2010.

The European market is Gazprom's first priority now and in the long term perspective. We have adjusted our export targets for pipeline gas exports to Europe from the current level to 180-190 bcm in the year 2010. The Yamal - Europe and the Blue Stream pipelines will become fully operational in order to facilitate this level of supplies. The North European Gas Pipeline (NEGP) is going to play a major role in increasing gas export supplies.

NEGP project is going to be a breakthrough in cooperation with the European natural gas consumers. The pipeline will run through the Baltic Sea from Vyborg to the coastline of Germany. Natural gas will be supplied via this pipeline to West Europe bypassing intermediaries and gas transiting countries. The NEGP construction will consolidate Gazprom's position as a leading natural gas exporter in the world, and as the guarantor of Europe's energy security, and will lead to more secure natural gas supplies for the European consumers.

NEGP's annual capacity will amount to 55 bcm of natural gas. The pipeline construction will start in autumn of this year, and its first gas line will be fully operational by 2010. Therefore, we will successfully expand the existing system of submarine pipelines, which has served Europe since the mid – 1970s.

It is obvious that Russia and Gazprom's strong positions in the international gas market predetermine potential increase in the company's valuation.

And now, let me switch over to Gazprom's financial position and corporate governance.

In 2004, Gazprom's income was record high and amounted to RUR 887.2 bln (excluding VAT). It was 13.7% higher than the 2003 income. Last year's net profit was RUR 161 bln. The Board of Directors recommends RUR 1.19 per share in dividend payments over 2004. This exceeds the previous year's level by 70%.

In 2004, Gazprom's financial position solidified further. A number of successful bond placements were initiated. Gazprom lowered the cost of financing and improved its debt portfolio structure by means of short term lending provided by Russian banks. Partial debt refinancing in the amount of US\$ 2.2 bln led to loan repayment terms' extensions, and 8 export contracts with annual contractual proceeds of US\$ 3.3 bln were uncollateralized, and more than US\$600 mln were recovered from reserve accounts.

We continue our efforts in optimizing all key procedures that characterize the quality of corporate governance, namely budgeting, financial control, investment decision process, refinancing, and bidding process. Special attention is devoted to systematic cost reduction.

Obviously, in the past several years, reporting quality and information disclosure standards have been enhanced and are now on par with the highest international levels. The management structure reform has led to further progress in this respect.

Dear shareholders!

The Strategy for success is the keystone of the company's investment attractiveness.

Gazprom continues to implement the strategy aimed at becoming an international energy corporation in all its core business activities. The business development strategy we are currently implementing facilitates the long term goal of corporate valuation enhancement in all respects.

Gazprom's major strategy elements are:

- diversification of business and end-products;
- new production and transportation technology implementation (liquefied natural gas, synthetic liquid fuels);
- transportation routes diversification;
- maintaining the leading position in the traditional markets and conquering new markets;
- vertical integration.

We intend to prioritize our strategic projects in order to concentrate our efforts within the most important business directions. In the short term perspective, Gazprom's key initiatives are the construction of the North – European natural gas pipeline, Yuzhno – Russkoye field development and the Shtokman project.

Dear shareholders!

In implementing our global strategy, mutually profitable asset swaps are a major principle of Gazprom's international cooperation in the natural gas business. Gazprom's requirements to its overseas counterparts are strict. We are interested in developing new markets and acquiring unique technologies. At the same time, our partners' financial position is not a prevailing factor.

The best example of cooperation based on assets swap is the signing of Memorandum with the German BASF in April, this year. This is the beginning of our joint energy strategy implementation and evolving interdependency of the energy industries of Russia and Germany.

BASF is our partner in the construction of the NEGP. This is the first example of a foreign company's participation in natural gas production within Russia at the Yuzhno – Russkoye field. The arrangements with BASF lets Gazprom consolidate its positions in Europe and acquire strategically important markets and assets, namely – gas pipelines and underground gas storage facilities in Europe.

The mechanism of interaction with overseas companies in implementing the NEGP project and the Yuzhno - Russkoye field development is based on energy cooperation, and we will use this mechanism in the future. Our gas reserves are substantial, and our partners possess unique technologies and the market. Together we can achieve great results.

Currently, Gazprom is primarily dealing in pipeline gas. Our global strategy stipulates reaching a high level of diversification in terms of end-products and becoming a full fledged international energy corporation with access to the US and Asian markets. We intend to become a global player in the LNG market. Gazprom is actively involved in arranging LNG production at the Shtokman field and entering the international LNG market. The marketing research is well under way. LNG supply to the Gulf of Mexico and the US east coast are most promising. The possibility of LNG supplies to Mexico and Canada intended for the US market are also studied.

Gazprom has already established close business ties with almost all the leading petroleum companies interested in the project.

Gazprom, consolidating its position in the gas industry and striving to achieve a qualitatively new level in its development, intends to consolidate the oil business and improve hydrocarbon processing, to expand high value added end product mix, including oil and natural gas chemicals production, markets and transportation routes diversification, and reaching new positions in electricity generation.

This multi-faceted strategy will allow Gazprom to use the advantages of liberalization and improve its shares' position in the stock market. The strategy will increase Gazprom's competitiveness compared to other large international petroleum corporations.

Evolving as an energy company, we concentrated substantial efforts in oil production. Currently, Gazprom produces around 12 mln t of liquid hydrocarbons annually. Oil production will increase in the near future when the Prirazlomnoye, Novoportovskoye, Tazovskoye and other oil and gas fields are brought into operation. Our strategy stipulates substantial expansion of oil business. We are studying the possibility of acquiring new assets both in Russia and abroad.

Gazprom, by acquiring substantial oil assets, will conduct further diversification of revenue sources, and will decrease its dependence on natural gas exports and national market supply. The corporate business structure will resemble that of the largest global energy market players, such as ExxonMobil, BP, RD/Shell. Currently, these companies' oil production share in the overall hydrocarbon production stands at around 55%.

We will have an opportunity to expand our activities in the processing sector by increasing the oil business share, and this includes oil refineries acquisition or construction both in Russia and abroad.

An energy company is inconceivable without electricity generation. Gazprom's strategic aim is to become a corporation involved in the complete petroleum chain – from production to sales – including natural gas, liquid hydrocarbons, and a wide array of end products, electricity being one of them.

Gazprom owns electricity generation facilities, but these are only separate projects intended to meet intra-corporate industrial consumption. In the future, Gazprom will enhance its position in the national electricity generation sector since it is one of the major natural gas consumers in the country. In 2004, Gazprom supplied electricity generation companies with 108 bcm of natural gas, which accounts for 37% of the total national gas supply.

Gazprom is also a major electricity consumer itself. For example, in 2004, the company consumed 18.6 bln kWh of electricity. Therefore, Gazprom's stake in national energy companies will allow it to have access to an important market segment, and to produce increased value added end products.

Besides, investments in electricity generation will assure Gazprom's position as an electricity consumer in terms of price stability, and will lead to new infrastructure development, enhanced competitiveness and operational flexibility. All large petroleum companies, including RD/Shell, BP, ENI and Total, are developing their own electricity generation business. Another trend is when electricity generating companies are evolving into powerful energy business holdings by acquiring natural gas assets.

Energy and related services are of a greater significance for the world than just merely oil, gas and coal consumption. The international energy market has generated the present-day trend of switching from single-profiled companies to global energy firms. The global energy industry formation is for Gazprom a primary indication that gaining access to the market of end services & products is of crucial significance today.

Currently, we're close to closing a deal with Gazprombank, planning to obtain energy assets in exchange for the media business. The Management Committee will advise the Board of Directors to decide on the energy asset consolidation in a specialized Gazprom wholly-owned subsidiary as well as on the business activity structuring in this sector. Thus, we'll transform power generation from merely an investment sector into a core business.

Dear shareholders!

We should be strongly positive of meeting all the challenges set while we count on the prominent gas reserves, potent UGTS and existing network of export pipelines, strong standing abroad and potential growth of home market attractiveness as well as new horizons being opened by the share market liberalization.

We have no doubt that Gazprom will shortly become a major player in the global energy market.

Thank you for your attention!