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Europe's Looming Gas Crisis: The Winners and Losers

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On June 16, without a lot of fanfare, Russian natural gas giant **OAO Gazprom** (NASDAQOTH: OGZPY) cut off supplies to Ukraine's state energy company Naftogaz. The move was in response to failed talks on Naftogaz paying a fairly substantial debt for previous shipments, and refusing Gazprom's plan to move to a prepayment system.

The fears about siphoning leading to a cut in Gazprom exports to Europe have so far been unfounded, with flows remaining normal and Ukraine using a substantial underground reserve of previous shipments. The EU gas crisis did not come to pass, at least not yet.

Why the EU isn't out of the woods yet

Though Ukraine's stored reserves amount to some 14.2 billion cubic meters, the country's massive dependency on foreign (i.e., Russian) supplied gas means they'll burn through that, at present usage, sometime in late autumn. Naftogaz officials are pushing for a state of emergency and forced 20% consumption cuts, which they say could allow them to get through the winter, albeit just barely, and only if it's not a particularly cold winter.

Whether it comes late this year or in early spring of 2015, one thing is clear: Unless Naftogaz resolves the standoff with Gazprom, something they insist they won't do, Ukraine will run out of gas in a matter of months. When that happens, siphoning is inevitable, and supplies to the rest of Europe will be in jeopardy.

Supply cuts from Russia will mean big price increases in Europe, as the few alternative sources of natural gas become all the more sought after. Major EU energy importers, like Germany's **E.ON** (NASDAQOTH: EONGY), are going to be paying out the nose for gas, if they can get it at all. Existing deals between E.ON and Gazprom are likely to be impossible to continue until the Ukraine situation is resolved.

Where will that gas come from?

The loss of Russian gas will be a much bigger problem for European customers than it will for Gazprom, which has been picking up its exports to China and India. It's far from ideal for Gazprom to have a cutoff to a whole continent, but they should easily weather that storm.

Europe, by contrast, is going to have to take a long, hard look at importing more liquified natural gas, which could be good news for companies like **BG Group plc** (NASDAQOTH: BRGYY), whose liquifaction plant in Egypt could benefit.

The other big natural gas producer in Europe is Norway's **Statoil** (NYSE: STO), which could greatly benefit from a dramatic increase in prices across the region. The company's profits are already flourishing on tight supply in Brent crude, and the natural gas crisis could add even more to their already healthy bottom line.

Companies by the numbers

While E.ON is trading for under its book value, its 0.62% profit margin means it doesn't have a lot of wiggle room to absorb massive price changes, and its 2.8% dividend yield is not worth the gamble until the Gazprom issue gets resolved.

Speaking of Gazprom, it remains very cheap for a company that is the world's largest natural gas producer by far. It's trading at only 0.34 times book, and 3.19 times projected FY2015 earnings. Despite Europe's risk to the bottom line in the medium term, the situation will eventually resolve itself, and a historic $400 billion gas deal with China reached in May ensures the company will have markets to sell to going forward.

Statoil is trading at about 10-11 times earnings, and 1.6 times book value. It also pays a secure 3.6% dividend. With prices of both Brent crude and natural gas on the rise in Europe, those earnings are liable to grow in the future. Their status as a European giant is still under-appreciated, and having so much production in such a stable part of Europe is something no one else can offer.

BG Group, by contrast, is a little more of a gamble. It is trading at 2.23 times book and 17.64 times FY2015 earnings. That's not exactly cheap, but as a major producer of liquefied natural gas, it is at the forefront of a growing, important market. Its supply to Europe depends in no small part on securing natural gas shipments to its Egyptian plant, and that means finalizing the Leviathan deal, so keep a close eye on that before jumping in too aggressively.

As always, the situation on the ground can change rapidly, so keep up with the news coming out of Ukraine and what impact it may have on European supply. The long-ignored country's status as a vital transit route is something many in Europe are just starting to realize, and finding alternative ways to ship gas is going to take quite some time, but it might make someone a lot of money.

Do you know this energy tax "loophole"?