
Russian Oil 2004

The Empire Strikes Back

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April 2004

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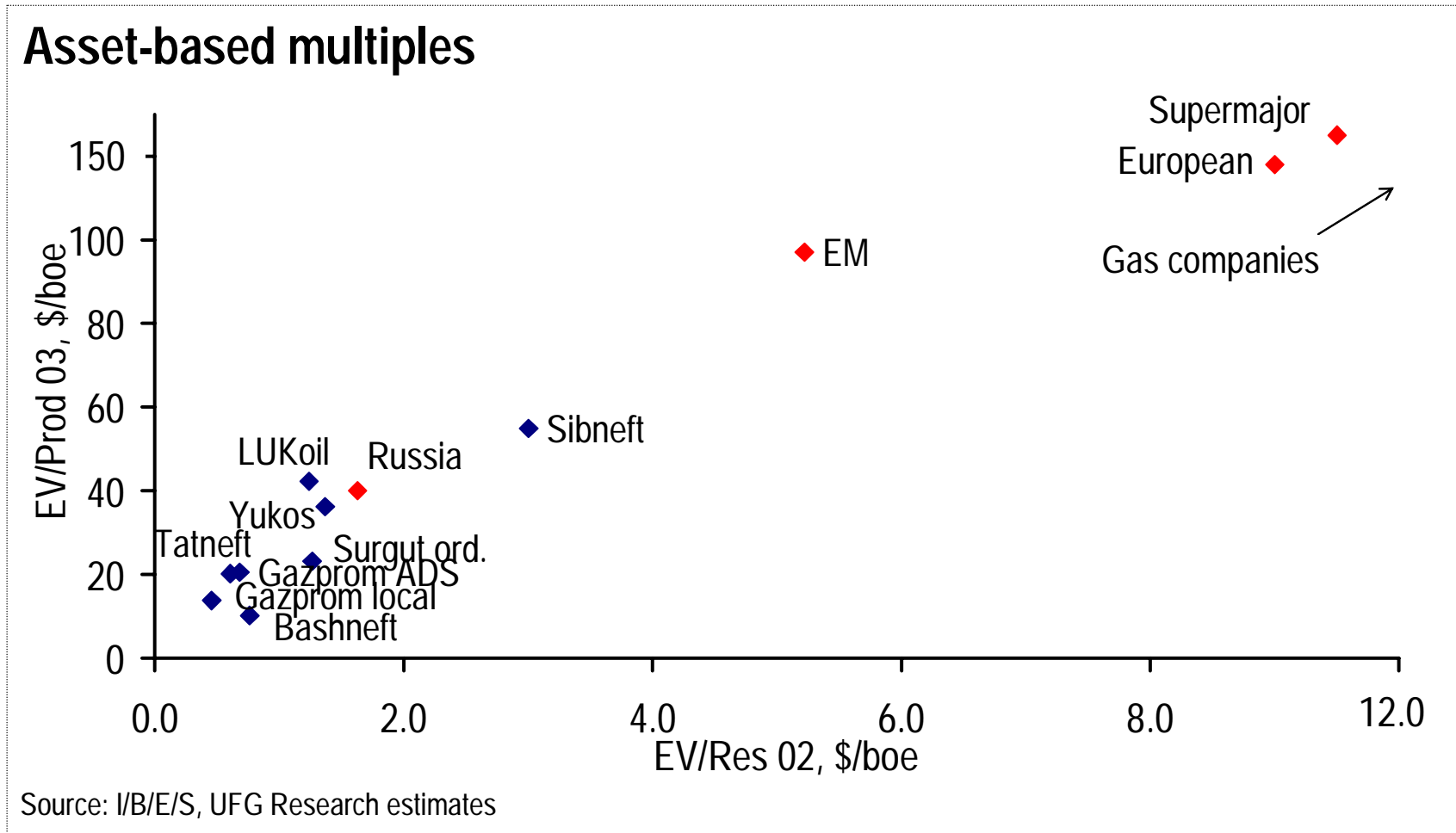


Key themes

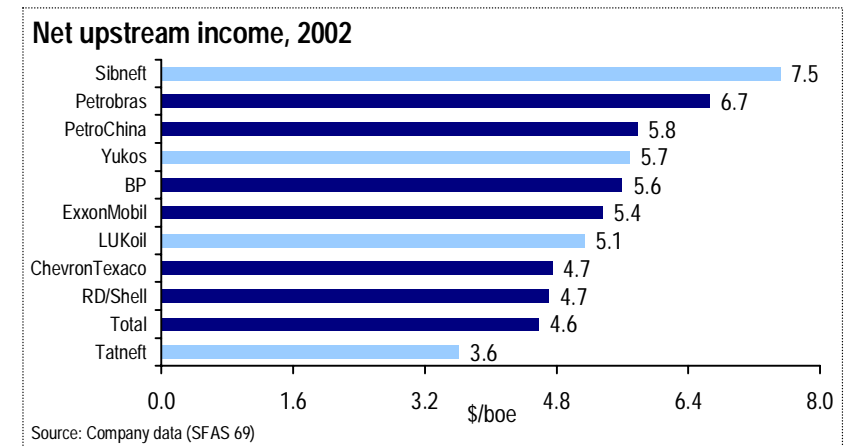
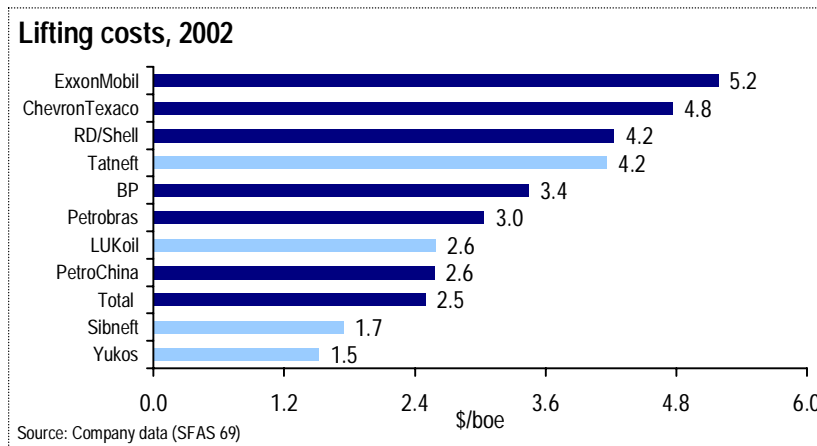
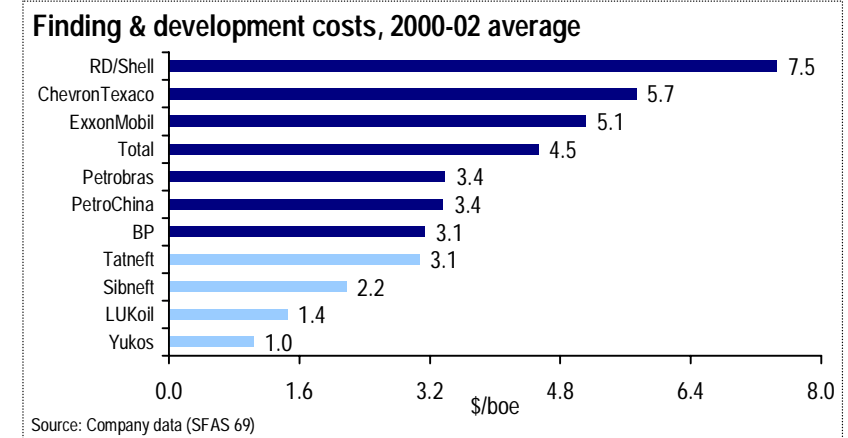
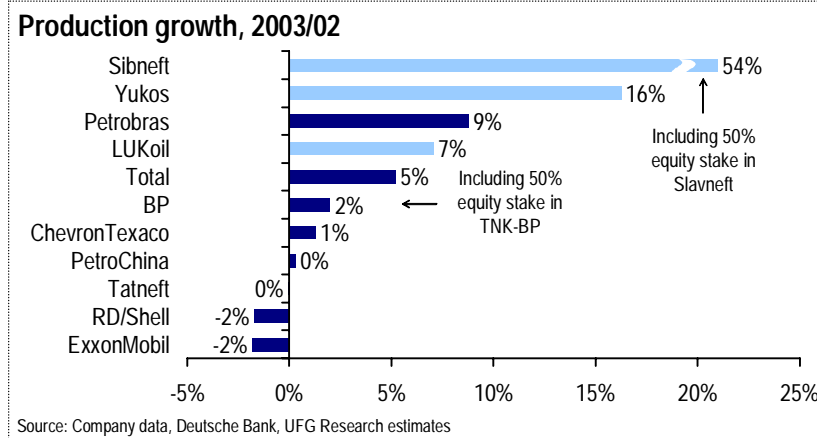
- ◆ Valuation
 - Underpriced globally but comparably priced on a GEM basis
 - Remains attractive to western oil companies
- ◆ Business & the state
 - Massive shift in balance of power
 - Revised position of state companies
- ◆ Commercial environment
 - Overall tougher
 - Higher prices, higher taxes (but only at the margin), higher costs
 - Higher production, but growth slowing
- ◆ Infrastructure
 - 2004 position is acceptable (but no more than that)
 - 2005 and beyond needs decisions or growth could suffer



Russian oils and global peers



Russian oils and global peers



Business & the state

- ◆ Massive shift in relations between business and the state
- ◆ Oligarchs are being put in their place - the question is how this is achieved. Could go either way in terms of investor sentiment
- ◆ Status and future role of state-owned companies:
 - Rosneft
 - Gazprom
 - Transneft
- ◆ We don't conclude that the private sector is hugely on the defensive – but the jury is out on this



Business & the state

- ◆ Tightening grip over strategic oil sector:
 - Taxation, licensing, social responsibility issues raised
 - Infrastructure to remain in state hands
 - Lobbying powers reduced as new Duma is loyal to President
- ◆ Russia favours state-owned or *quasi* state oil companies:
 - Gazprom and Rosneft represent government interests on a large scale (Eastern Siberia, Arctic shelf, Sakhalin)
 - A loyal Surgutneftegaz joins consortium with Gazprom and Rosneft to implement large-scale plan to develop East-Siberian reserves
 - LUKoil may act as Russia's representative on a global basis (Caspian, Eastern and Central Europe, US retail market, Saudi Arabia gas contracts)



Business & the state

- ◆ Oil restructuring and consolidation entering final stages
- ◆ Top-tier: Yukos, LUKoil, TNK-BP
- ◆ Portfolio management replaces asset acquisition
- ◆ Rosneft: 100% state-owned, nucleus of future state oil company, privatisation candidate in medium-term
- ◆ Transneft: ordinary shares 100% state-owned, no prospect of change because of government's desire to retain control
- ◆ Licence auctions: most likely route for companies to develop a new business



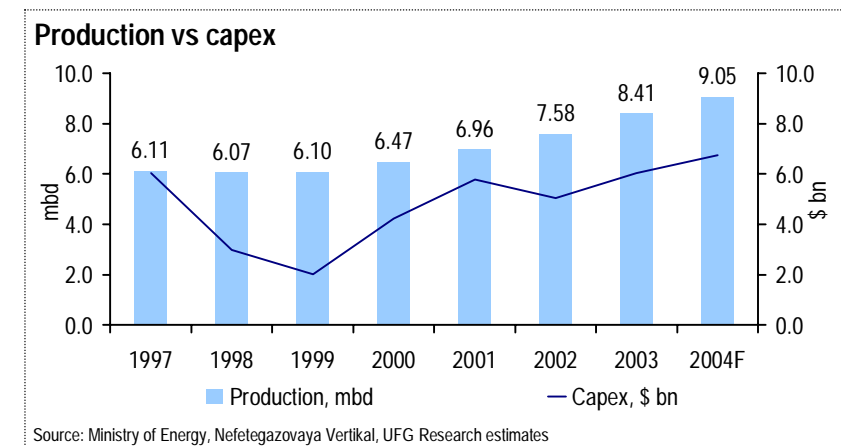
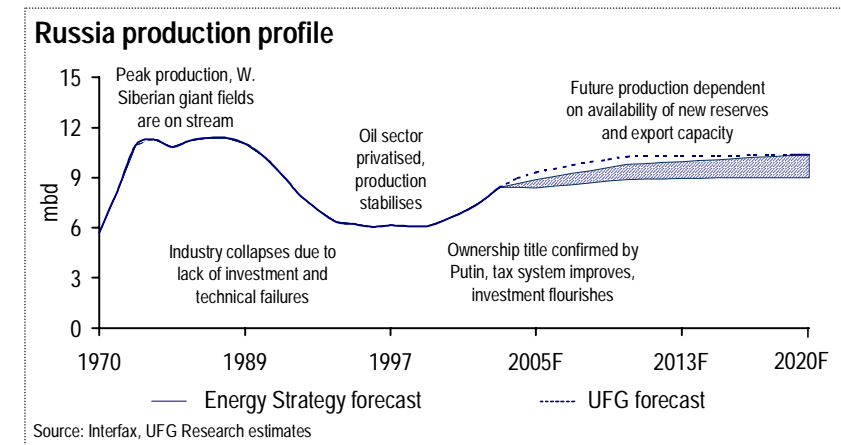
Operating environment - summary

- ◆ Expect it to be slightly tougher in 2004 and beyond – although there are bright spots
- ◆ Brent oil prices remain very firm, domestic oil prices likely to be higher
- ◆ Taxes will rise, but only at the margin and not dramatically overall (+6-7%) and not as the beginning of a windfall tax raid on the sector
- ◆ Regulatory changes – shifting from licensing to contracts, which we see as a positive development
- ◆ Costs are rising – a booming sector is suffering from input cost inflation and capacity constraints. In the medium-term projects will be costlier and take longer to pay back



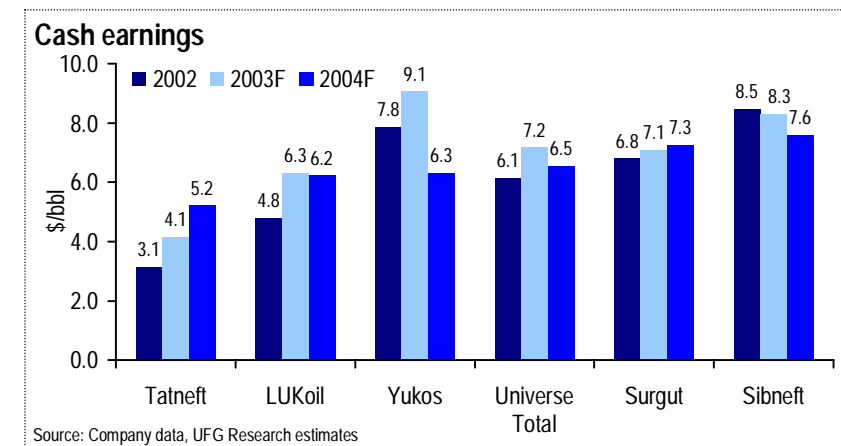
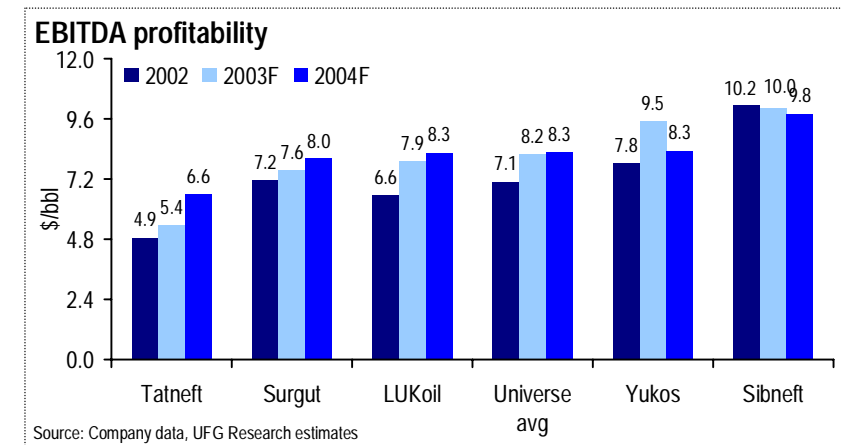
Operating environment - production & capex

- ◆ Sustainability of production growth:
 - availability of new reserves
 - availability of export capacity
 - need for continued investment
 - concern about property rights and impact on planned capex



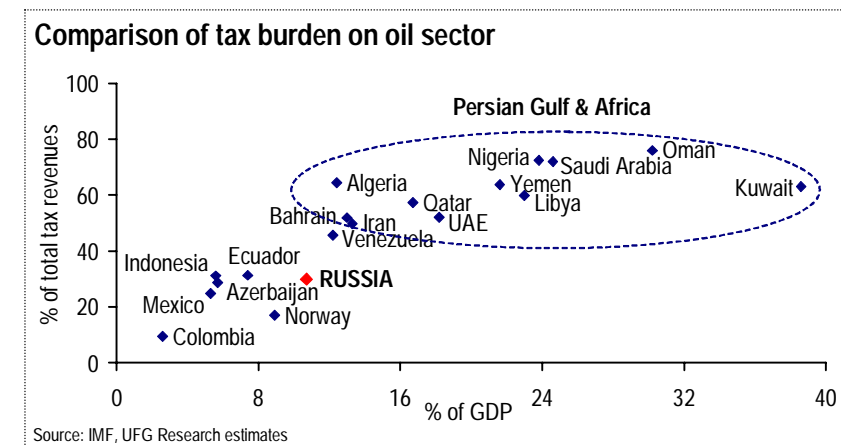
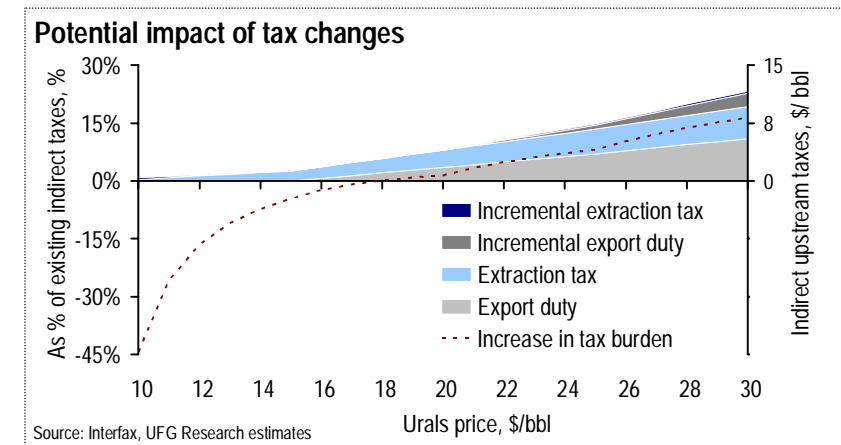
Operating environment - financing

- ◆ Russian oil companies continue to generate record-high cash flows
- ◆ Yukos and Sibneft have consistently demonstrated their ability to lead the sector
- ◆ Higher expected crude oil price is offset by higher costs and taxes leading to lower cash generation



Operating environment – tax changes

- ◆ Impact on financials and valuations still unclear:
 - Base-case scenario: an increase of \$800 mn for the sector at \$25/bbl
 - Low impact if Brent oil price averages below \$25/bbl
 - Higher taxes mean steeper valuations
 - But sector tax system may now stabilise, although clarity on Putin comments needed

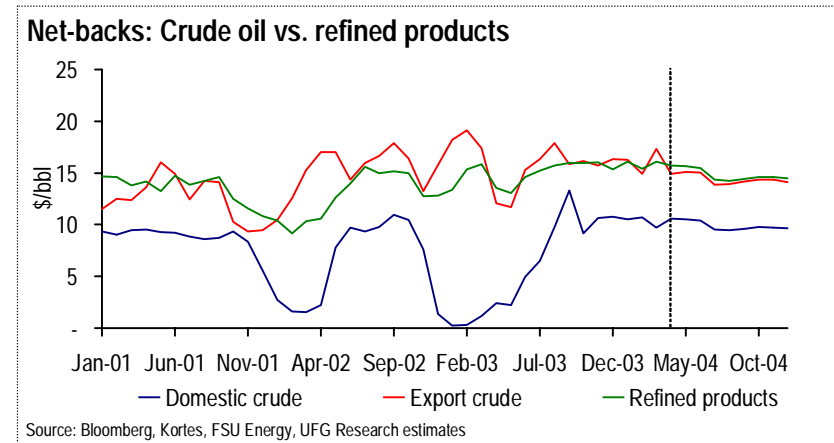
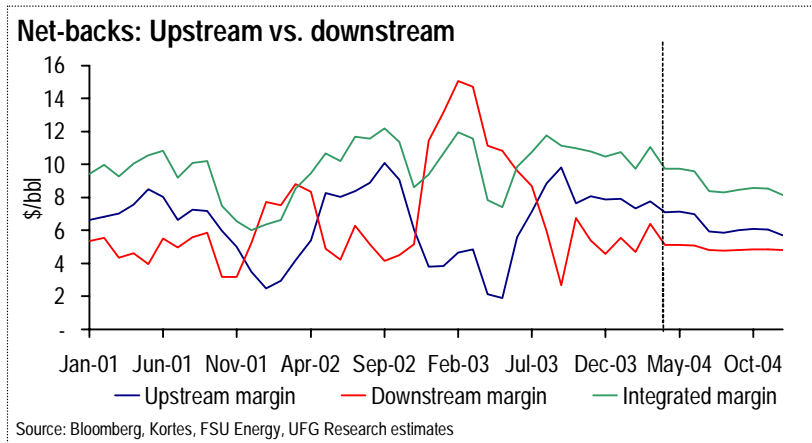


Oil infrastructure

- ◆ Key issue for 2004 but remains controversial
- ◆ Crude infrastructure expansion matches output growth in 2004 (~600 kbd) – no worsening of the current situation
- ◆ Problems in 2005 -2006 as output expands faster than capacity
- ◆ Major infrastructure (Murmansk, Asia) unlikely to commission until 2007-2008 – but decisions need to be taken now.
Government policy on infrastructure expansion has not been encouraging
- ◆ Product export capacity continues to rise as companies seek alternative routes to market

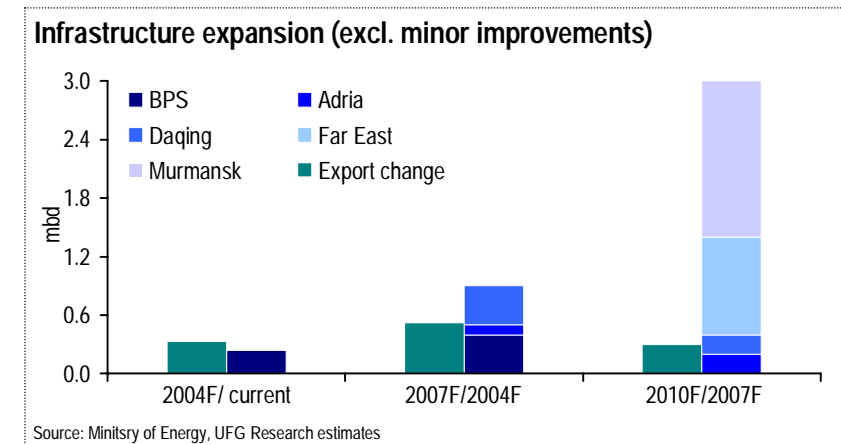
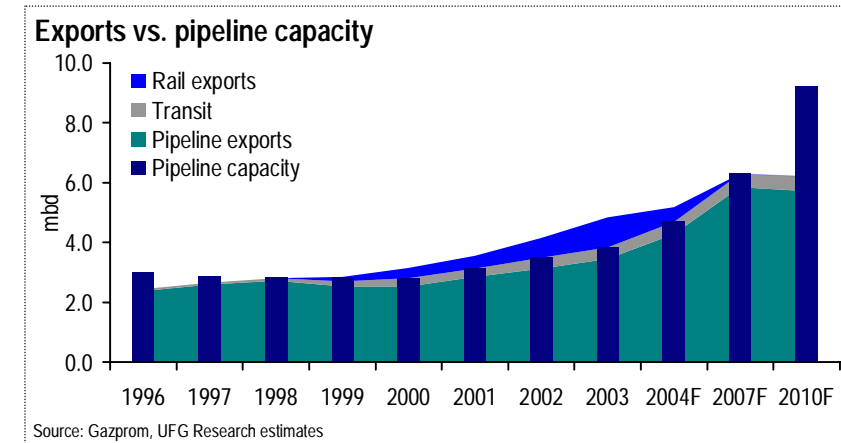


Oil infrastructure



Oil infrastructure

- ◆ Bottlenecks remain the main factor restricting further crude production growth
- ◆ BPS expansion should help facilitate crude exports
- ◆ Government dithering about approving new projects:
 - Angarsk-Daqing
 - Taishet-Perevoznaya, Far East
 - West Siberia-Murmansk



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