

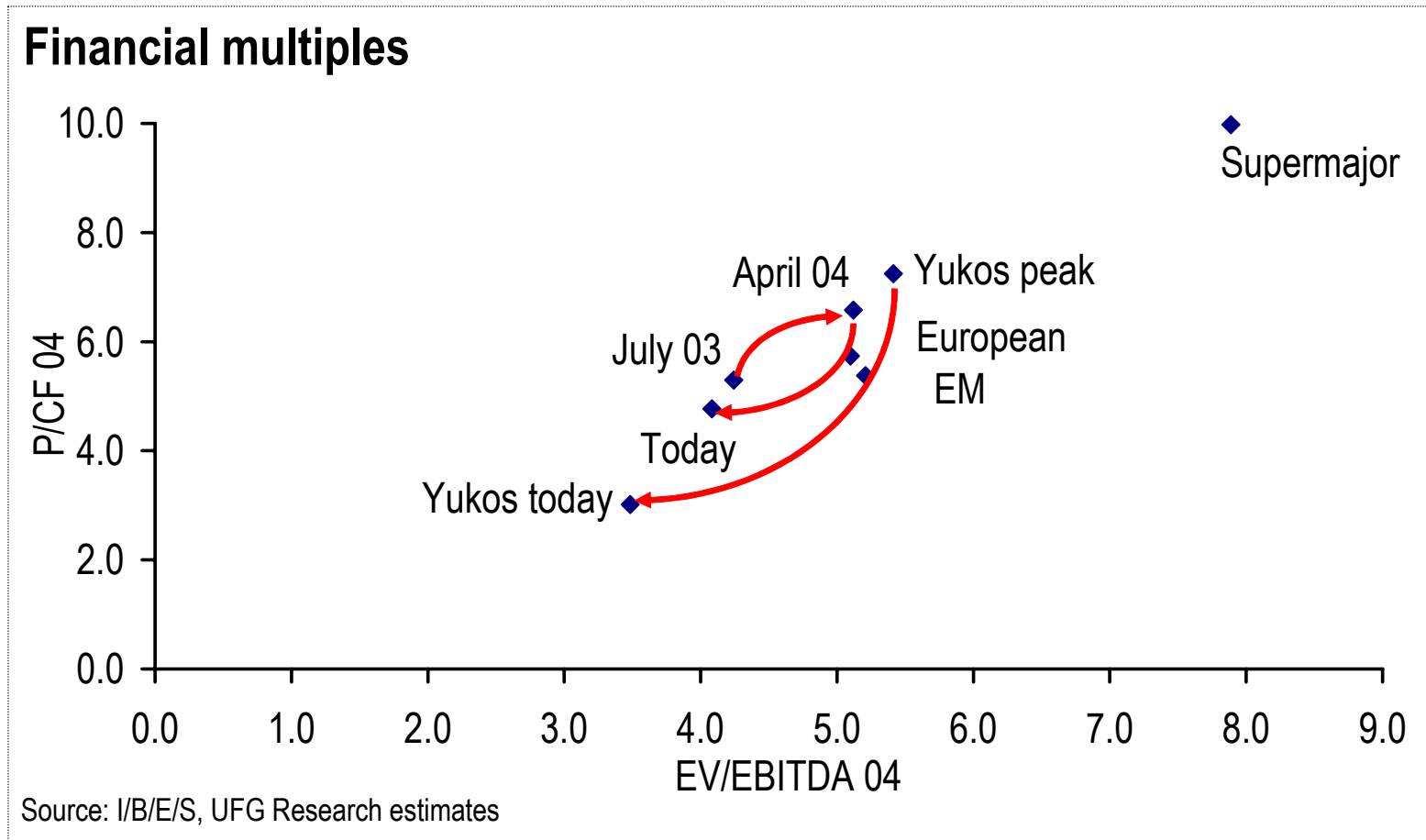
Energy Investment in Russia: The Empire Strikes Back

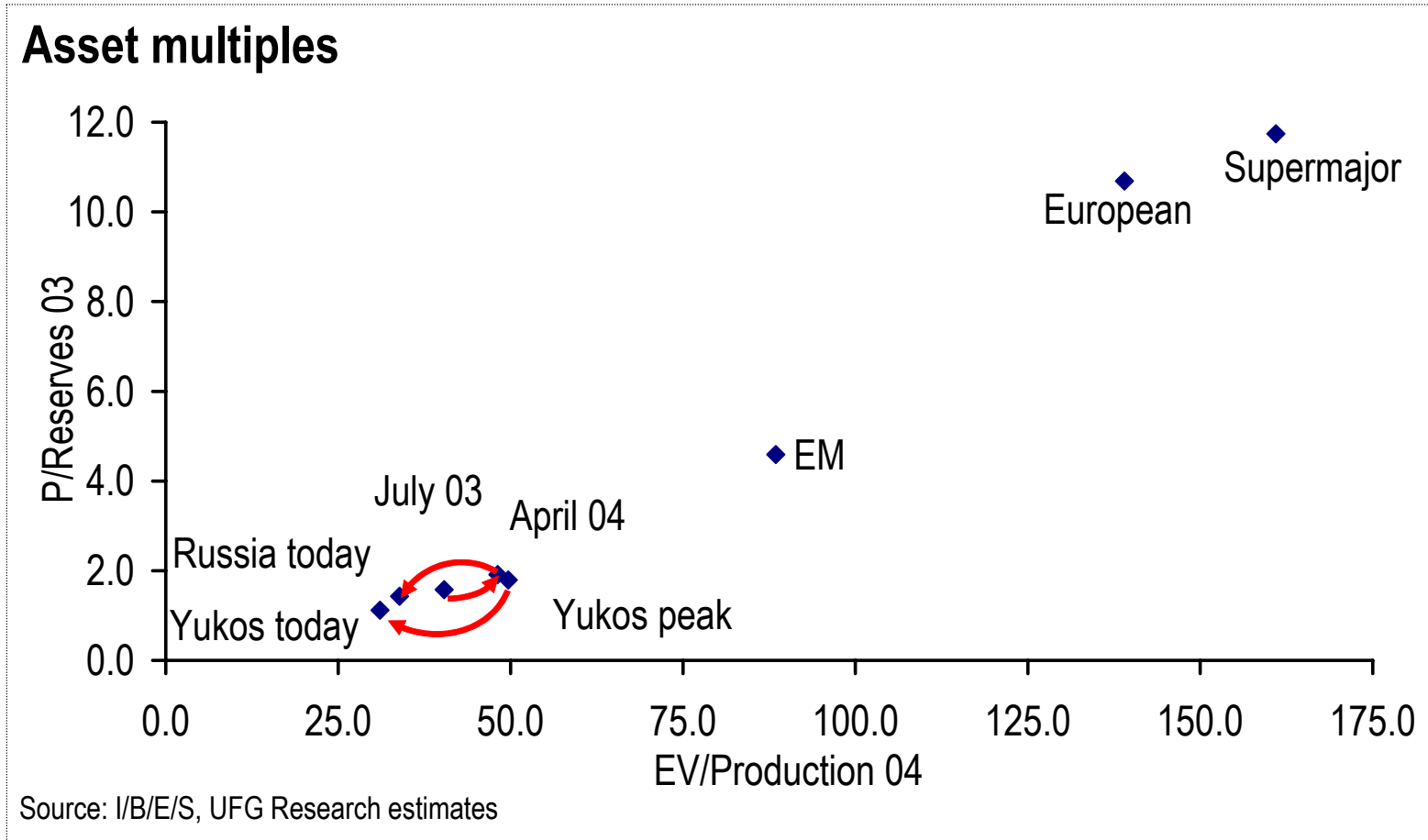
Stephen O'Sullivan

Washington
8 July

Overview

- ◆ Valuation
- ◆ Political background
- ◆ Macroeconomic environment
- ◆ Commercial environment
- ◆ Business and the state





Political Background

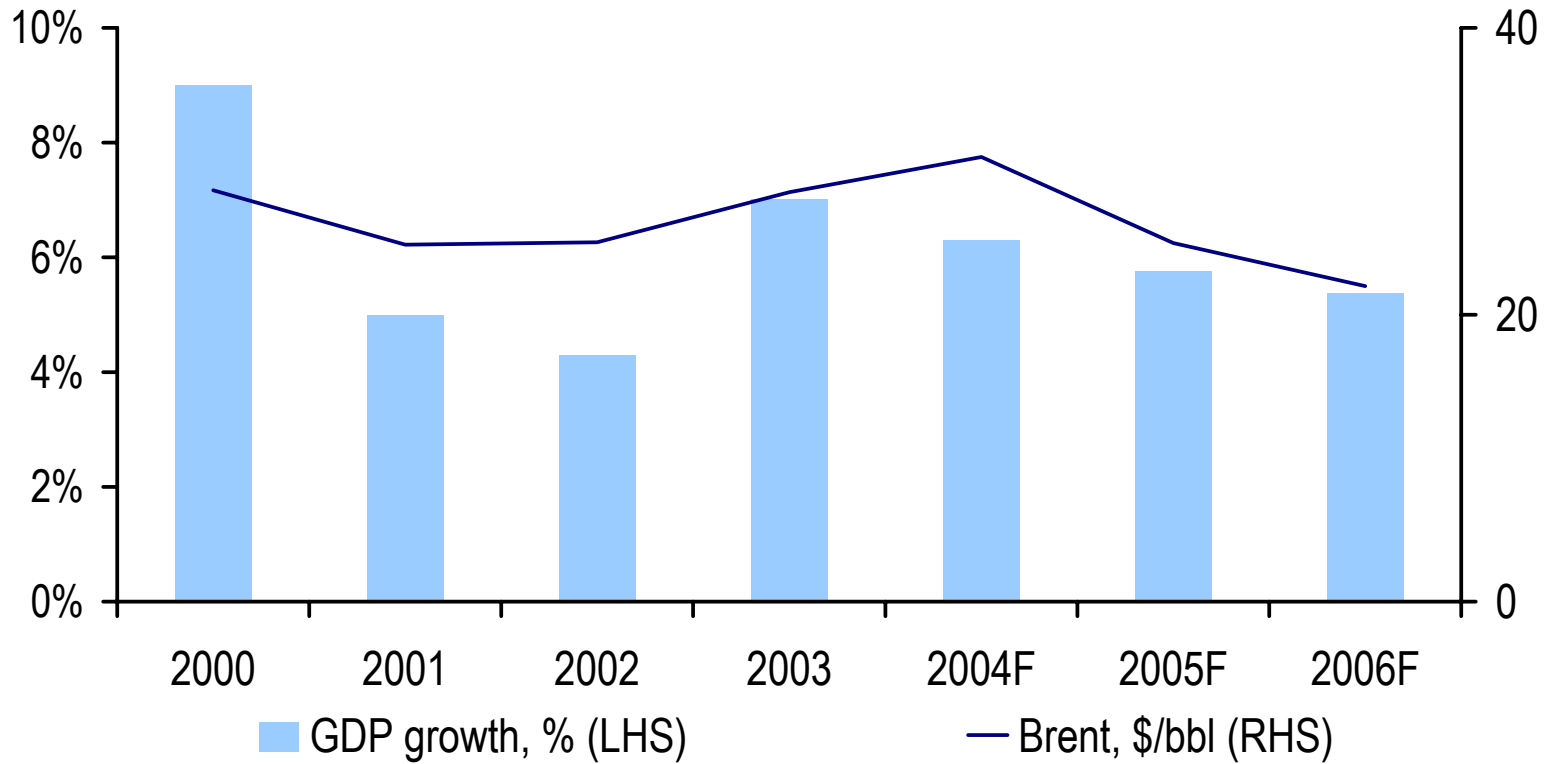
- ◆ Putin re-elected with substantial majority in March 2004
- ◆ Compliant Duma elected in December 2003
- ◆ “Reformist” government installed in February 2004
- ◆ Limited progress on reform
- ◆ Attractive returns + security of investment = positive investment climate
- ◆ Who is really in charge?

Macroeconomic Environment

- ◆ Supportive external environment
- ◆ Limited but sensible government policies
- ◆ Most indicators look positive:
 - 2004 GDP 6.2 %
 - current account: + \$ 24.7bn
 - fiscal surplus: 1.3 %
 - inflation: 11.8 %
 - real exchange rate appreciation: 15 %
- ◆ Challenge remains to avoid Dutch disease and carry through reforms

Macroeconomic Environment

GDP growth vs. Brent price



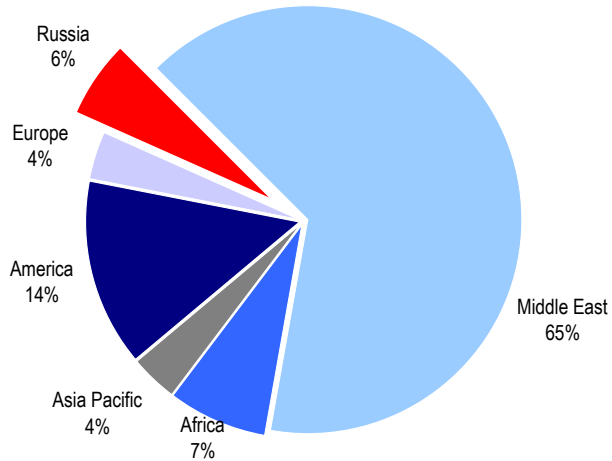
Source: Goskomstat, Bloomberg, UFG Research estimates

Commercial Environment

- ◆ Reserves
- ◆ Production
- ◆ Costs
- ◆ Taxes
- ◆ Infrastructure

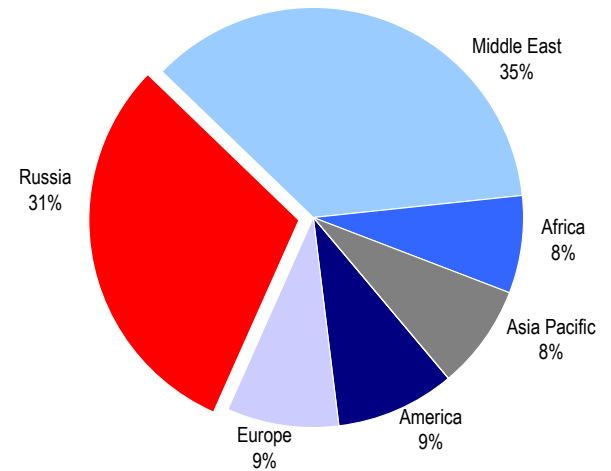
Commercial Environment - Reserves

Russia as a proportion of world oil reserves



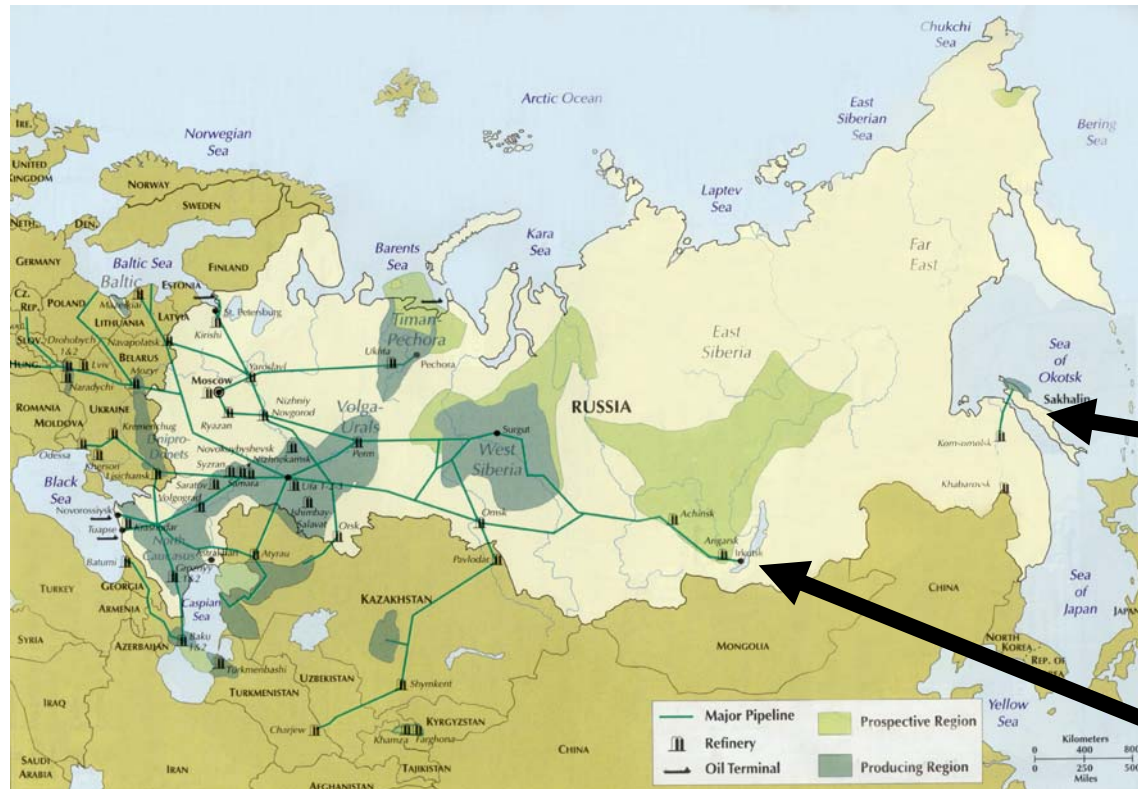
Source: BP Statistical Review

Russia as a proportion of world gas reserves



Source: BP Statistical Review

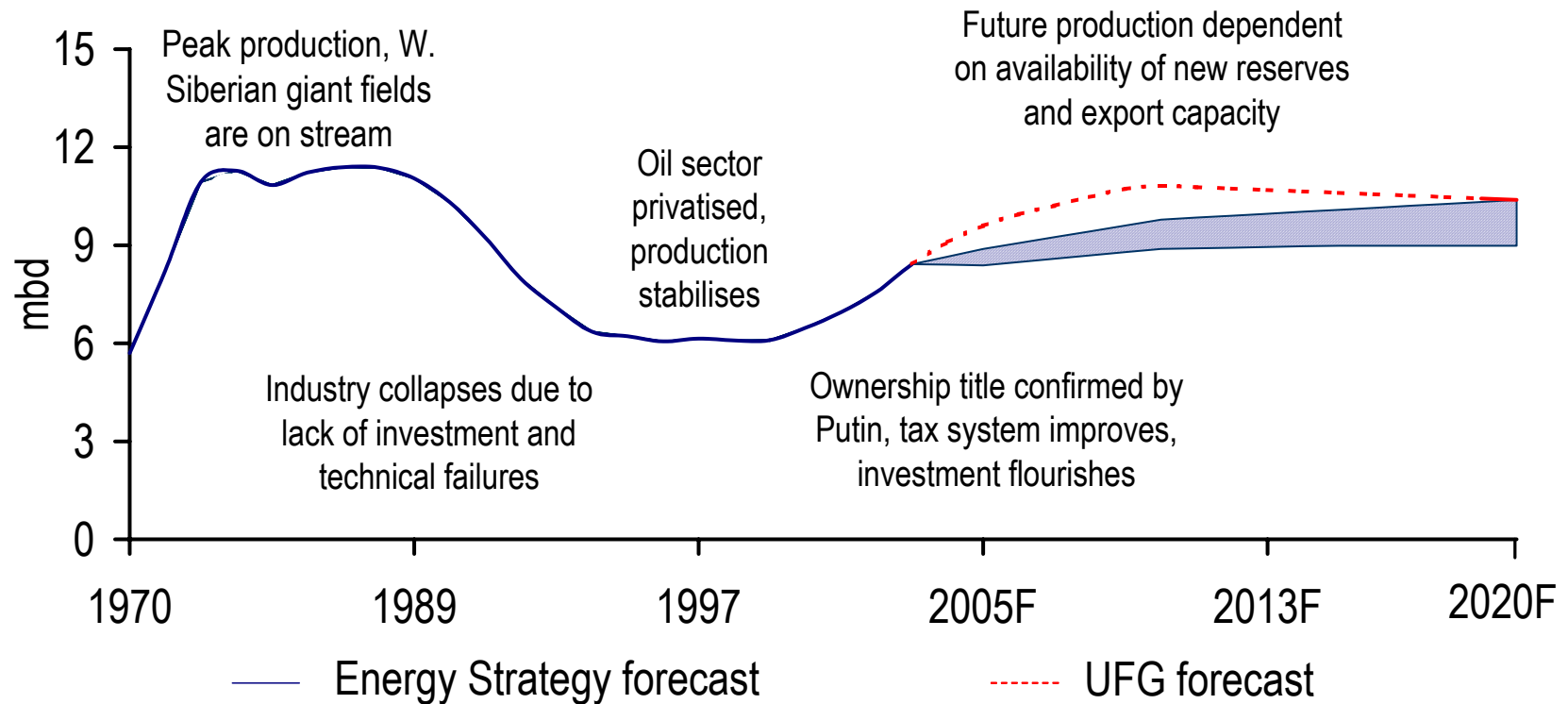
Commercial Environment - Reserves



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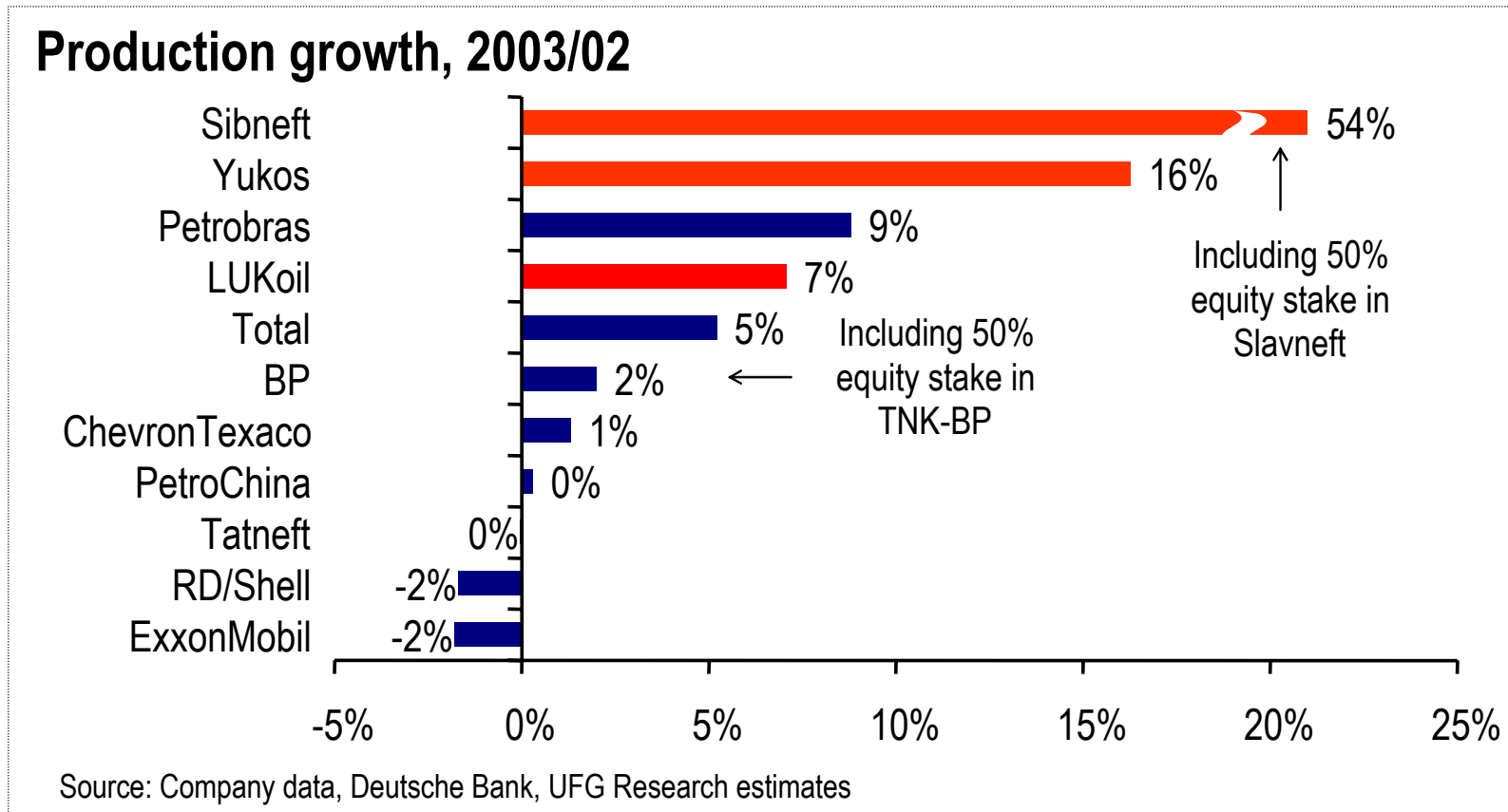
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Russia production profile



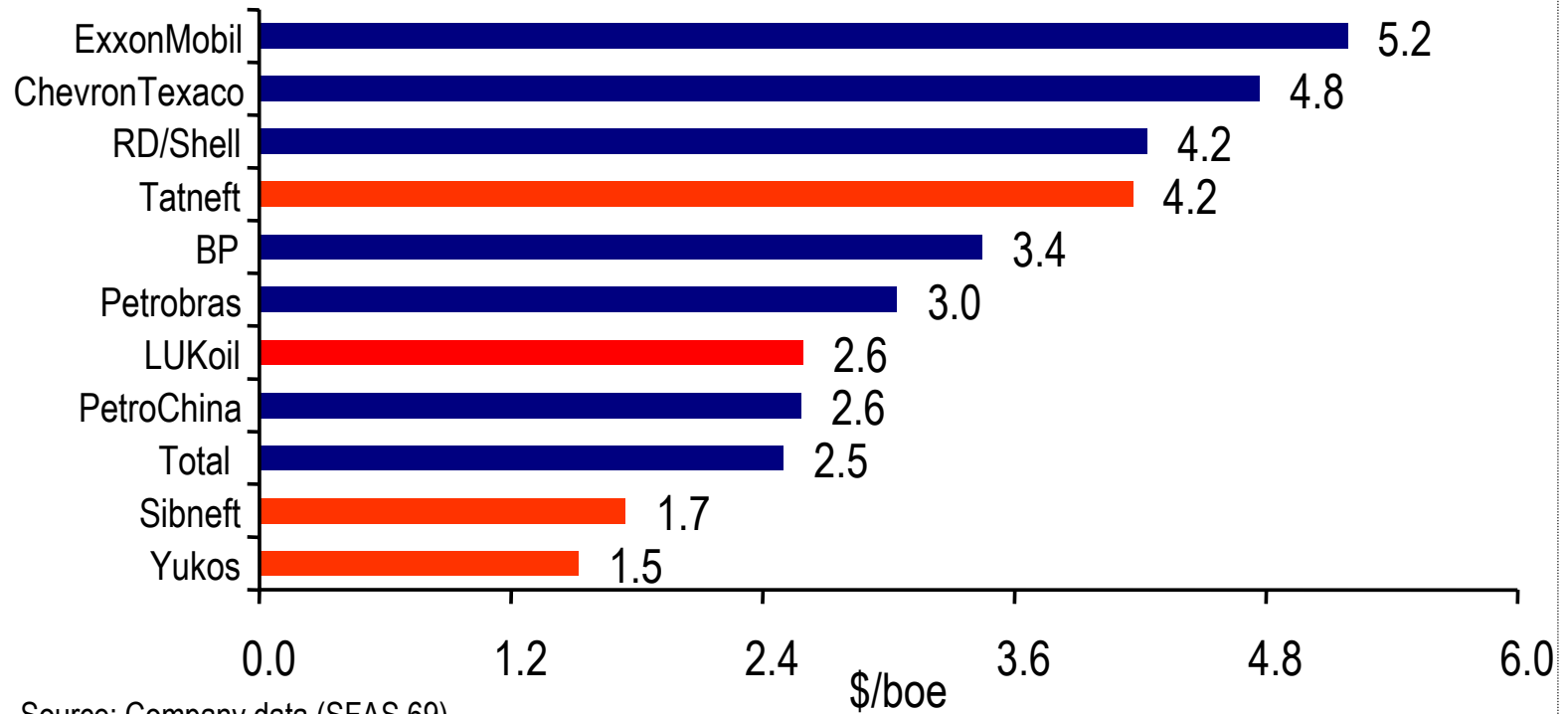
Source: Interfax, UFG Research estimates

Commercial Environment - Production



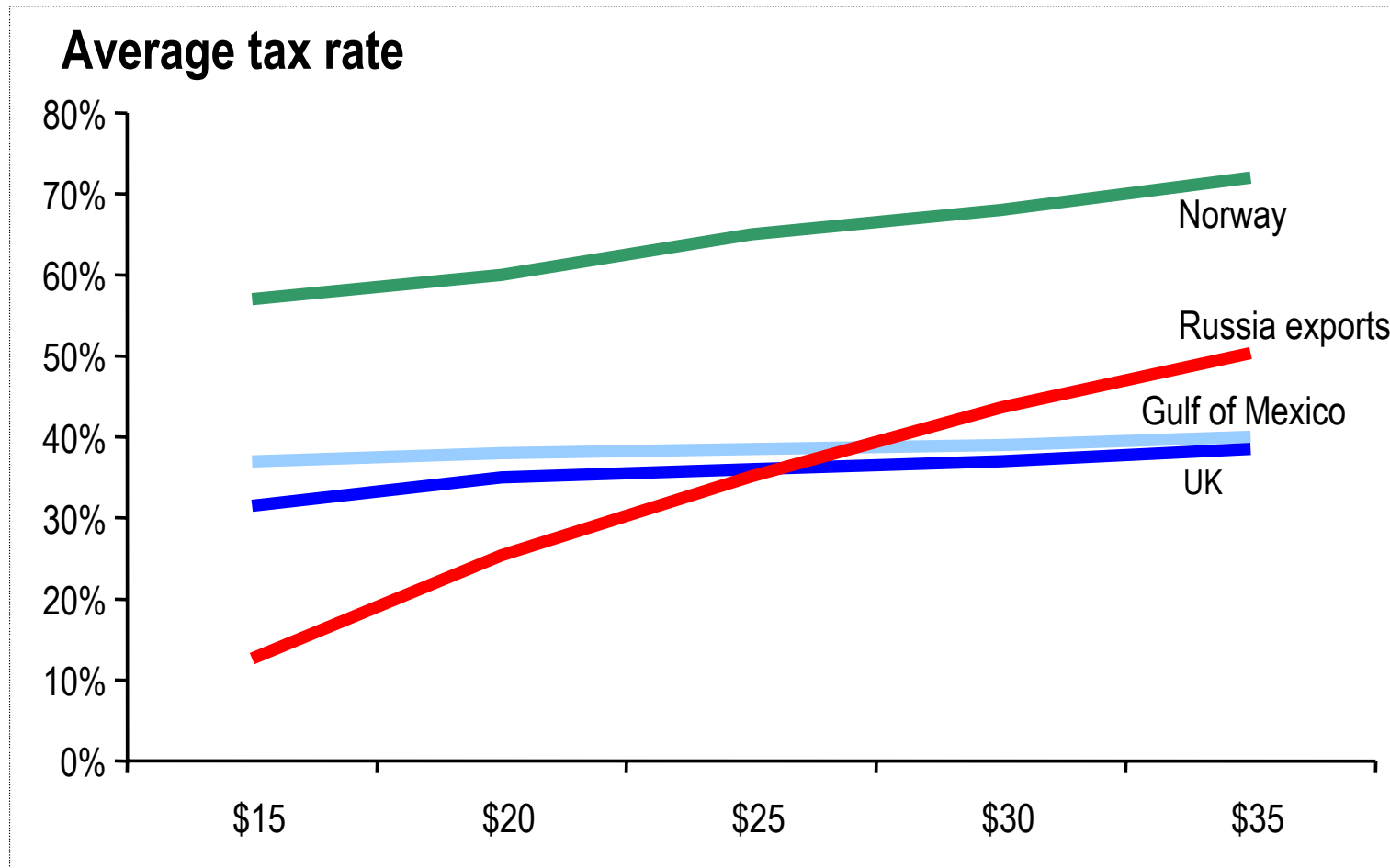
Commercial Environment - Costs

Lifting costs, 2002



Source: Company data (SFAS 69)

Commercial Environment - Taxes



Commercial Environment - Infrastructure



Business & the State

- ◆ Massive shift in balance of power from business to the state
- ◆ Key issue is security of investment, not attractiveness
- ◆ Khodorkovsky affair destabilized market & sentiment
- ◆ Concerns of contagion to other oligarchs – not so far
- ◆ Criminal and civil trials closely related
- ◆ Appearance of due process...but not the substance
- ◆ Legacy of mid-90s privatisation which still needs to be addressed

Russia is changing rapidly



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Rating key

Underperform: This indicates that the analyst expects the stock to underperform the MSCI Russia Index by at least 10% over the subsequent 12 months

Market Perform: This indicates that the analyst expects the stock to perform in line with the MSCI Russia Index (i.e. no more than +/- 10%) over the subsequent 12 months

Outperform: This indicates that the analyst expects the stock to outperform the MSCI Russia Index by at least 10% over the subsequent 12 months

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