Energy Investment in Russia: The Empire Strikes Back

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Energy Investment in Russia

Overview

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

Financial multiples

Source: I/B/E/S, UFG Research estimates
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Valuation

Asset multiples

Source: I/B/E/S, UFG Research estimates
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
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Macroeconomic Environment

GDP growth vs. Brent price

Source: Goskomstat, Bloomberg, UFG Research estimates
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Commercial Environment

- Reserves
- Production
- Costs
- Taxes
- Infrastructure
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Commercial Environment - Reserves

Russia as a proportion of world oil reserves

- Russia: 6%
- Europe: 4%
- America: 14%
- Asia Pacific: 4%
- Africa: 7%
- Middle East: 65%

Source: BP Statistical Review

Russia as a proportion of world gas reserves

- Russia: 31%
- Middle East: 35%
- Asia Pacific: 8%
- Africa: 8%
- Europe: 9%
- America: 9%
- Russia: 31%
- Middle East: 35%
- Asia Pacific: 8%
- Africa: 8%
- Europe: 9%
- America: 9%

Source: BP Statistical Review
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Commercial Environment - Reserves

Sakhalin

Kovykta
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Commercial Environment - Production

Russia production profile

- Peak production, W. Siberian giant fields are on stream
- Future production dependent on availability of new reserves and export capacity
- Industry collapses due to lack of investment and technical failures
- Oil sector privatised, production stabilises
- Ownership title confirmed by Putin, tax system improves, investment flourishes

Source: Interfax, UFG Research estimates
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Commercial Environment - Production

Production growth, 2003/02

- Sibneft: 54% growth
- Yukos: 16% growth
- Petrobras: 9% growth
- LUKoil: 7% growth
- Total: 5% growth
- BP: 2% growth
- ChevronTexaco: 1% growth
- PetroChina: 0% growth
- Tatneft: 0% growth
- RD/Shell: -2% growth
- ExxonMobil: -2% growth

Including 50% equity stake in Slavneft
Including 50% equity stake in TNK-BP

Source: Company data, Deutsche Bank, UFG Research estimates
Lifting costs, 2002

- ExxonMobil: $5.2/boe
- ChevronTexaco: $4.8/boe
- RD/Shell: $4.2/boe
- Tatneft: $4.2/boe
- BP: $3.4/boe
- Petrobras: $3.0/boe
- LUKoil: $2.6/boe
- PetroChina: $2.6/boe
- Total: $2.5/boe
- Sibneft: $1.7/boe
- Yukos: $1.5/boe

Source: Company data (SFAS 69)
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Commercial Environment - Taxes

Average tax rate

Norway
Russia exports
Gulf of Mexico
UK
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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
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Russia is changing rapidly
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Disclosures

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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