



# International Partnership and the Future of Russian Oil and Gas

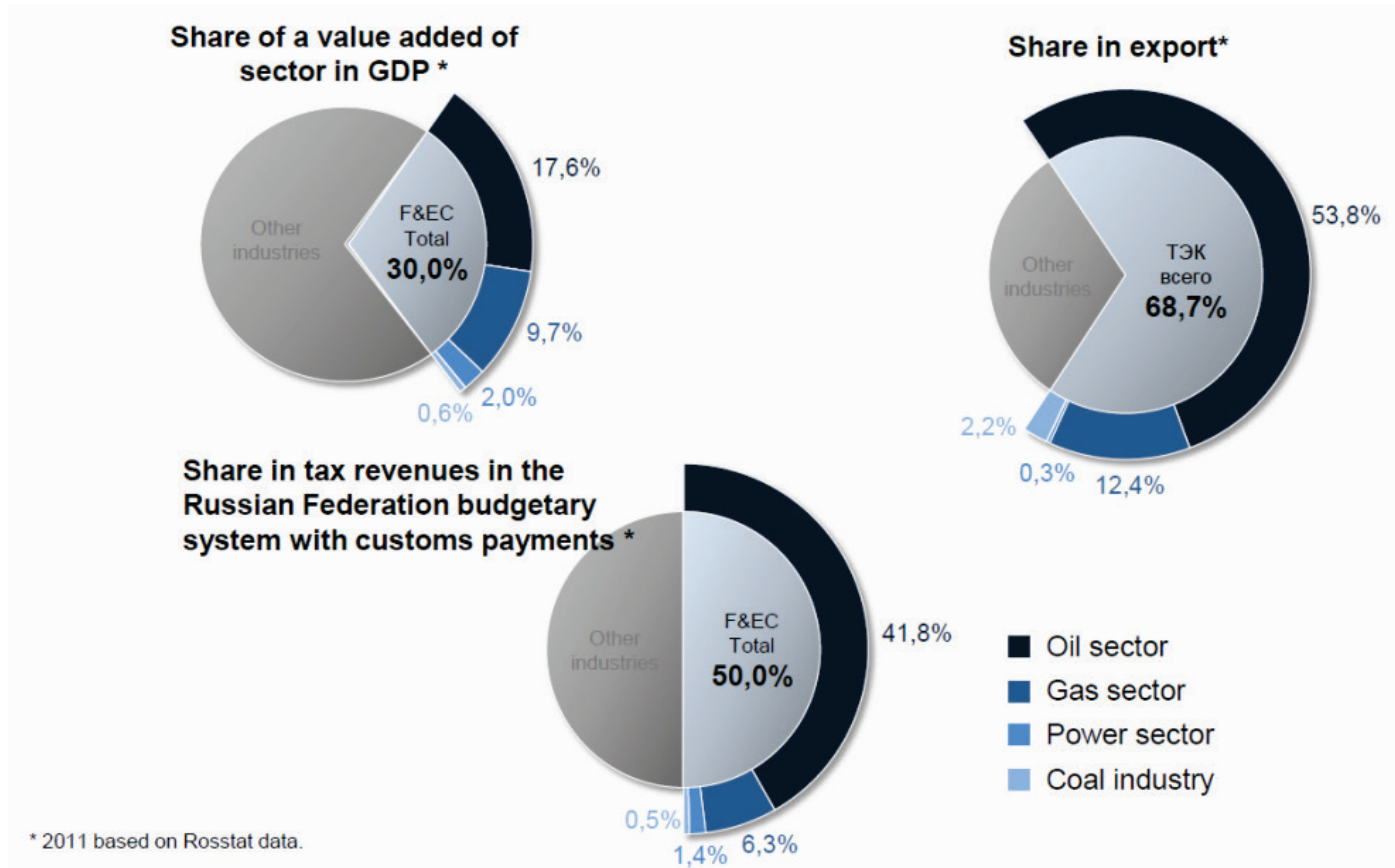
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# Structure

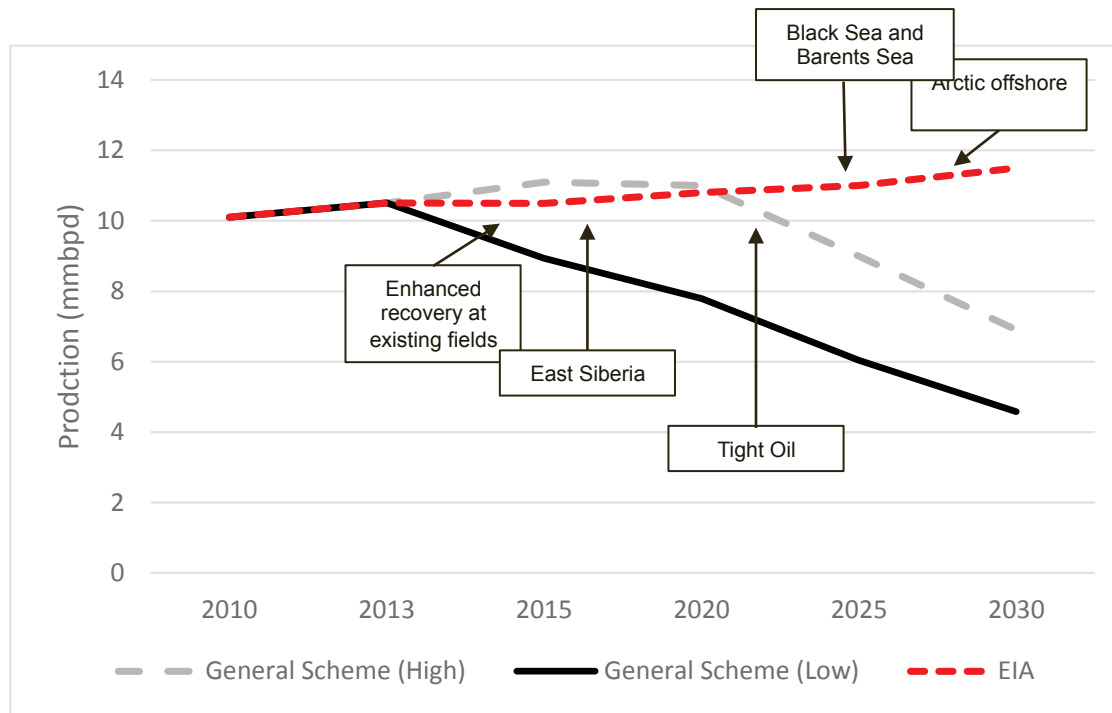
- Current issues for the Russian oil sector
- Areas of IOC participation
- Challenges for foreign partners in Russia
- Some thoughts on addressing the risks

# The oil sector underpins Russia



- The oil sector makes by far the largest contribution to Russian budget revenues, dwarfing the gas sector

# Russia's oil production outlook



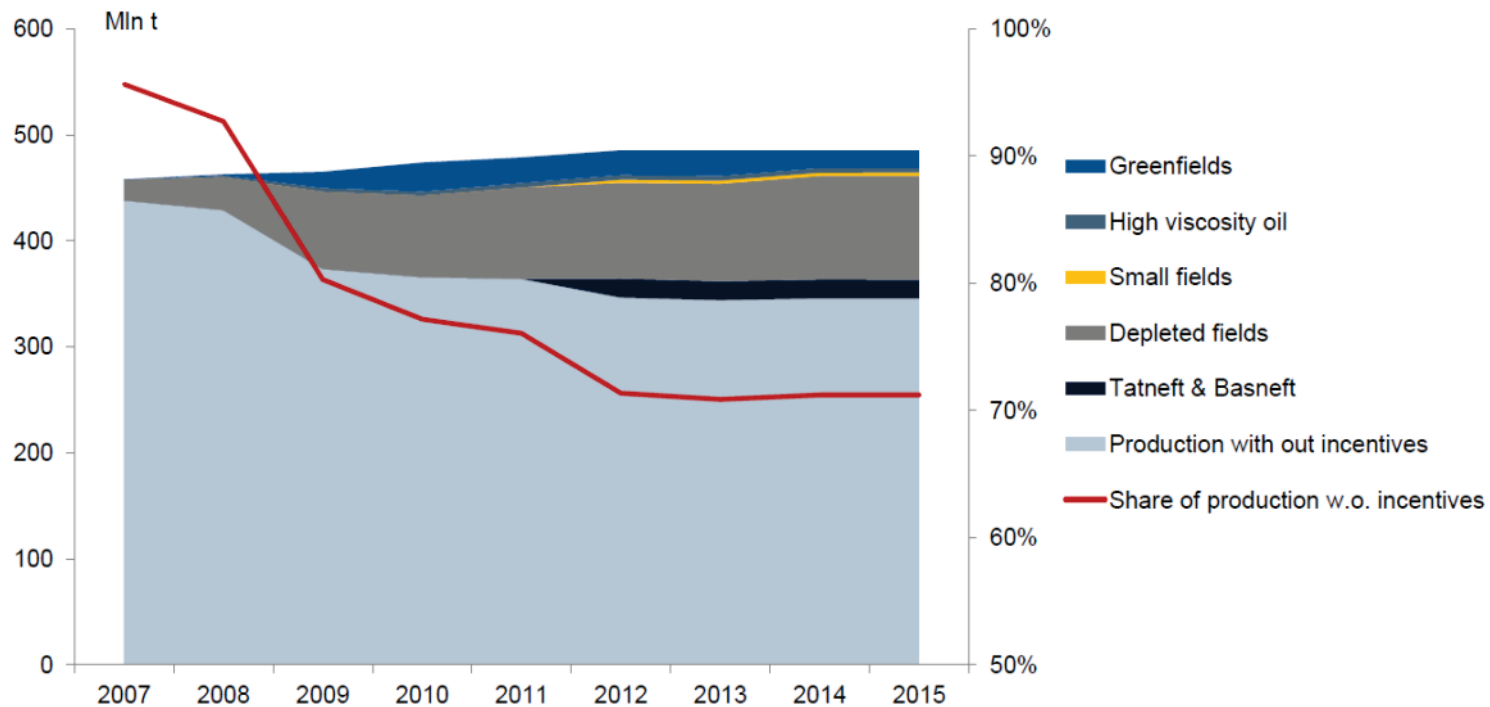
Source: Ministry of Energy, General Scheme of Development of Oil industry to 2020, EIA International Energy Outlook 2013

- Maintaining Russian oil production above 10mmbpd is becoming more challenging
- IOCs will be important contributors of technical experience, management expertise and financing for difficult projects
- Partnership is vital to the future of Russia's oil (and gas) sector

# Russia has an oil tax problem

*Tax concessions have underpinned stable oil output*

**Dynamics of oil production structure\***



\* Without PSA and condensate

Source: Mitrova 2014

- Russian oil production would already be in decline if tax concessions had not been made to specific types of projects
- Production must not be allowed to fall below 10mmbpd or the tax revenues problem will be compounded

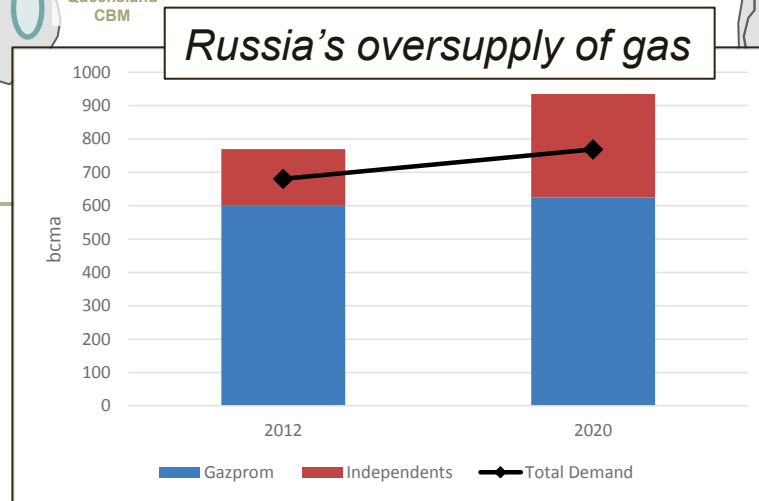
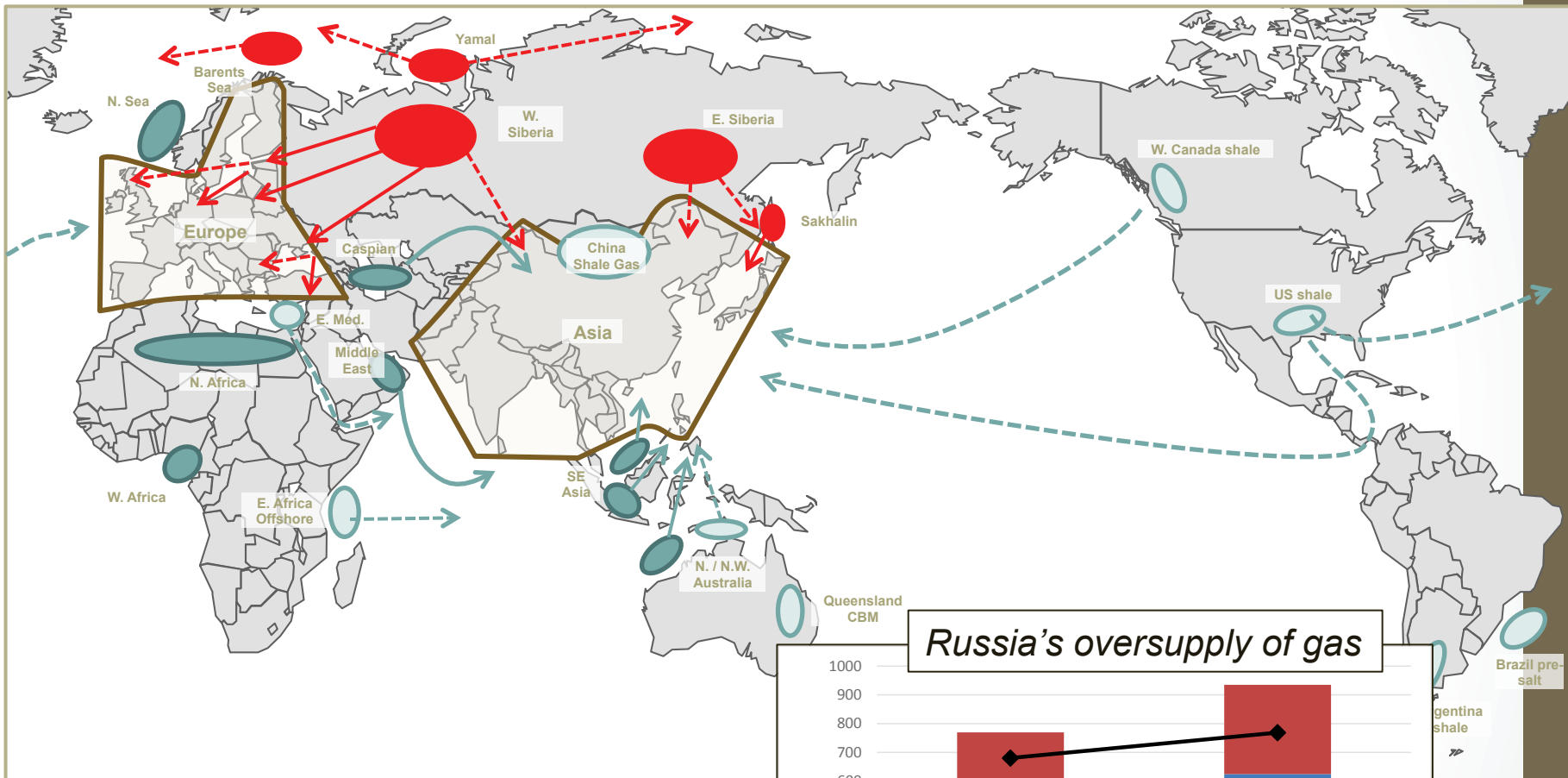
# The Russian gas sector is adapting to a new role

<b>SUPPLY SOURCES:</b>	<b>2002</b>	<b>2008</b>	<b>2012</b>	<b>2013</b>
<b>Gazprom production</b>	<b>522</b>	<b>550</b>	<b>487</b>	<b>487</b>
<b>Non-Gazprom production</b>	<b>73</b>	<b>114</b>	<b>169</b>	<b>181</b>
<b>Central Asian imports</b>	<b>34</b>	<b>68</b>	<b>29</b>	<b>33</b>
<b>TOTAL</b>	<b>629</b>	<b>732</b>	<b>685</b>	<b>701</b>
<b>MARKETS:</b>				
<b>Russian gas demand (UGSS)</b>	<b>412</b>	<b>462</b>	<b>465</b>	<b>461</b>
<b>Exports to CIS countries</b>	<b>89</b>	<b>89</b>	<b>63</b>	<b>57</b>
<b>Exports to Europe (physical Russian gas)</b>	<b>129</b>	<b>159</b>	<b>139</b>	<b>162</b>
<b>LNG Exports to Asia</b>	<b>0</b>	<b>0</b>	<b>14</b>	<b>14</b>
<b>TOTAL</b>	<b>630</b>	<b>710</b>	<b>681</b>	<b>694</b>

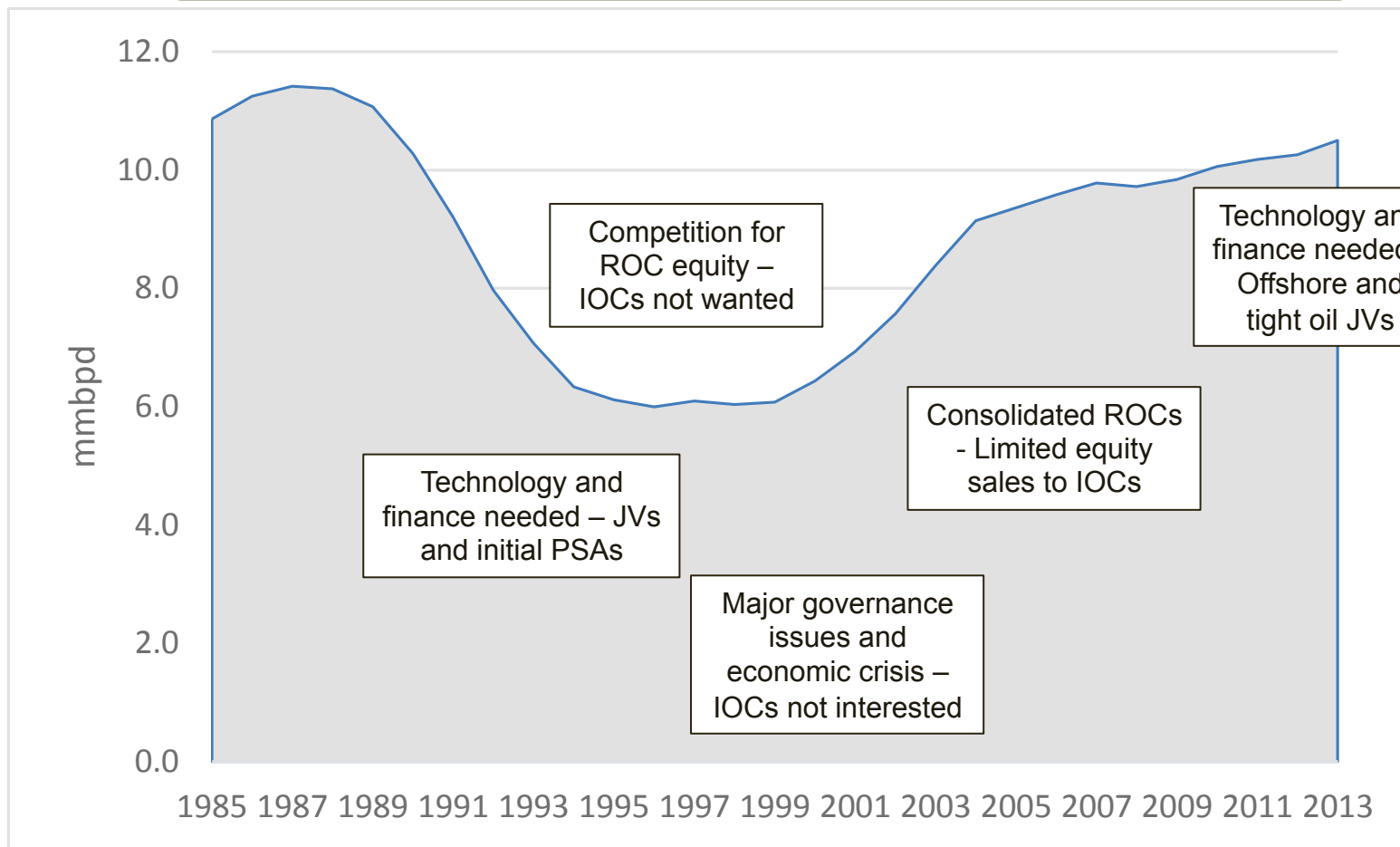
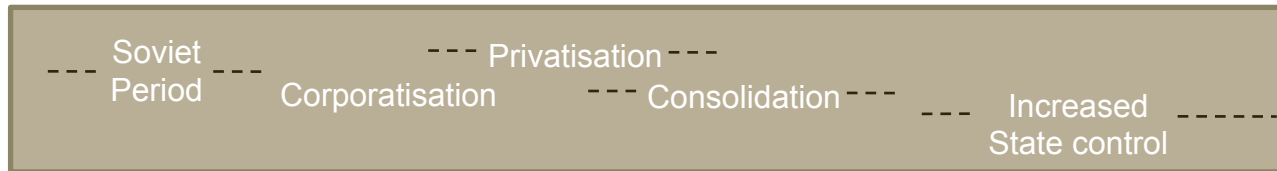
Source: Gazprom

- Gazprom and gas sector have had to balance political and commercial objectives, but this is becoming increasingly difficult
- Gazprom has lost a significant amount of control over the Russian gas matrix
- Russian gas sector will need to generate more budget revenues while adapting to increasingly competitive global market

# Is Russia becoming the global gas swing producer?

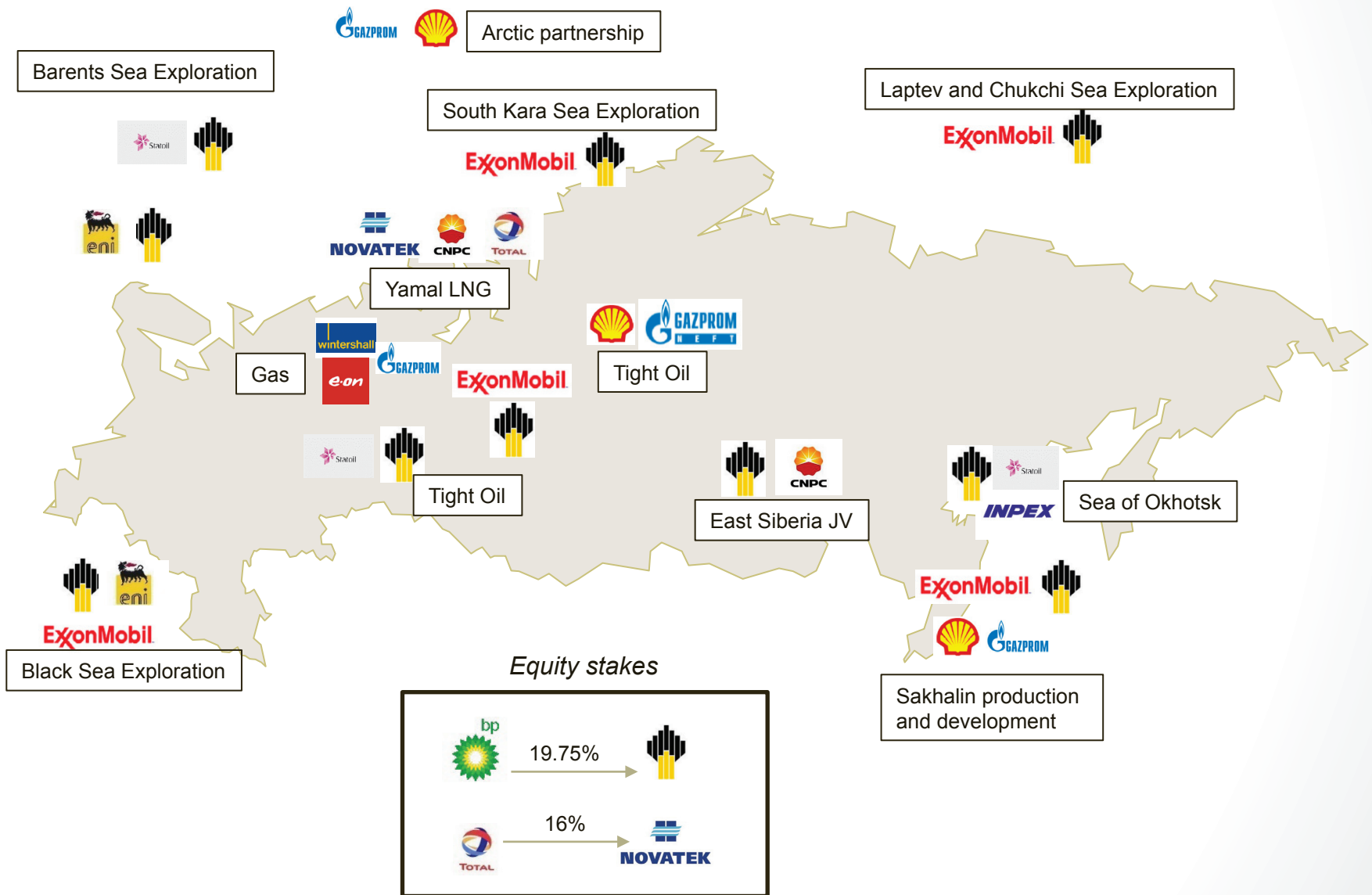


# A short history of IOCs in Russia



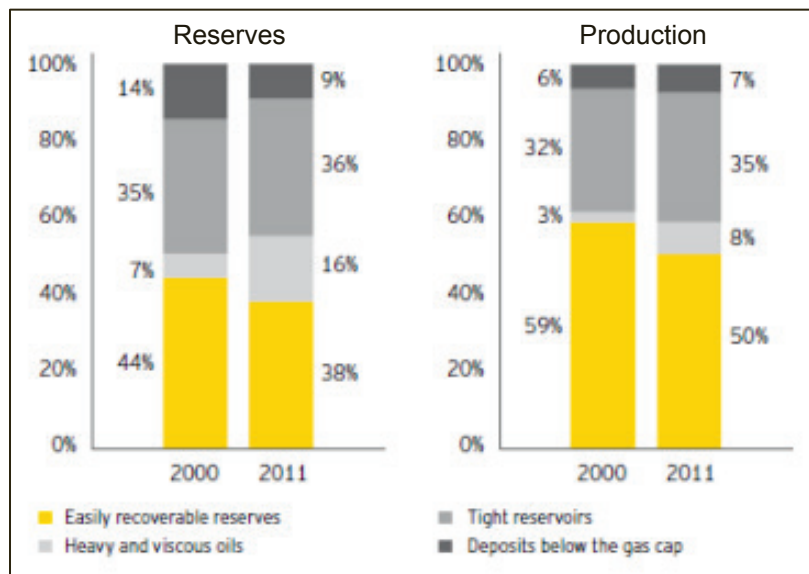


# IOC activity in Russia in 2014



# Brownfield recovery through EOR

*Russia's oil is getting more difficult*



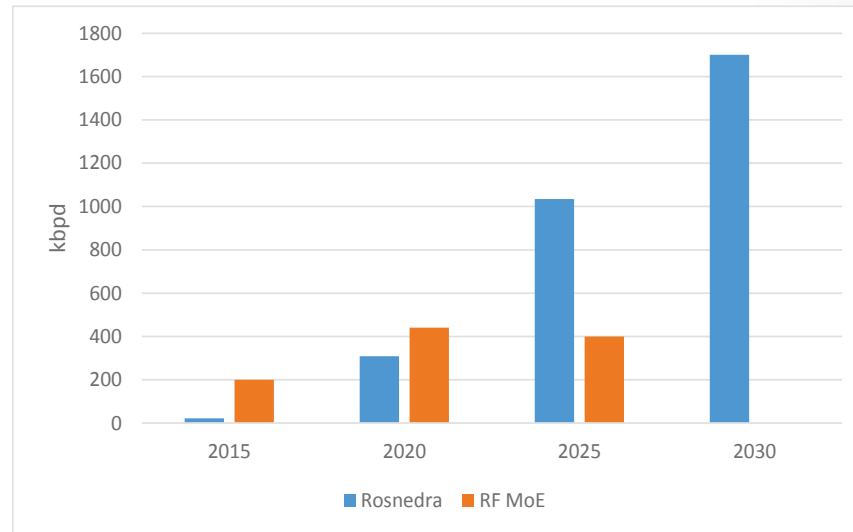
Source: E&Y

- Difficult to recover reserves account for 62% of Russian total
- IEA estimates that EOR could account for 500k bpd of output by 2030
- Enhanced waterflooding techniques and reservoir management already in use
  - Water cut averages 80%
- Tertiary methods gradually being introduced as tax incentives increase
- International techniques brought by IOCs and service companies

# Tight oil developments for medium term

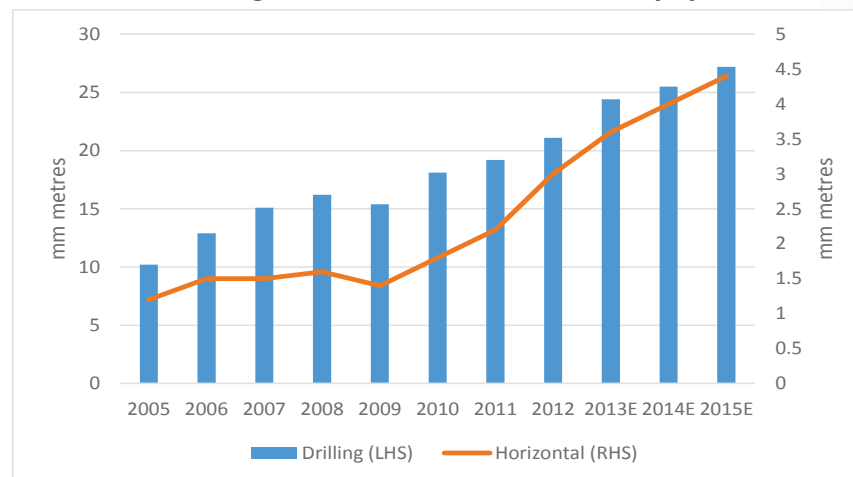
- Expectations for unconventional oil are running high
  - Largest prospective resource base in the world
  - The Bazhenov shale is current focus
- Exxon, Statoil, Total and Shell all have JVs with Russian companies
- Production estimates range up to 1.5mmbpd by 2030
- Many issues need to be resolved
  - Tax, service industry capacity, technology, funding
- Commercial environment not conducive to fast development

Output expectations from shale oil



Source: Rosnedra, RF MoE

Drilling set to increase sharply

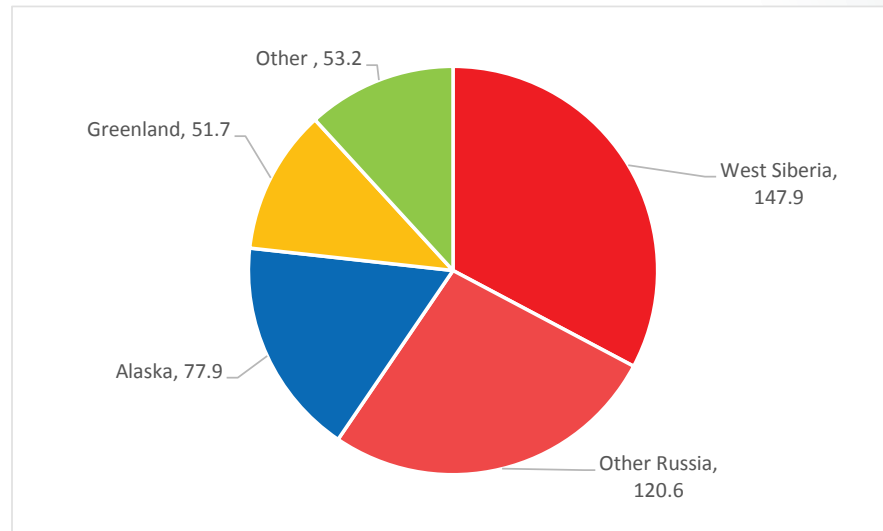


Source: OIES

# Arctic exploration – long-term upside

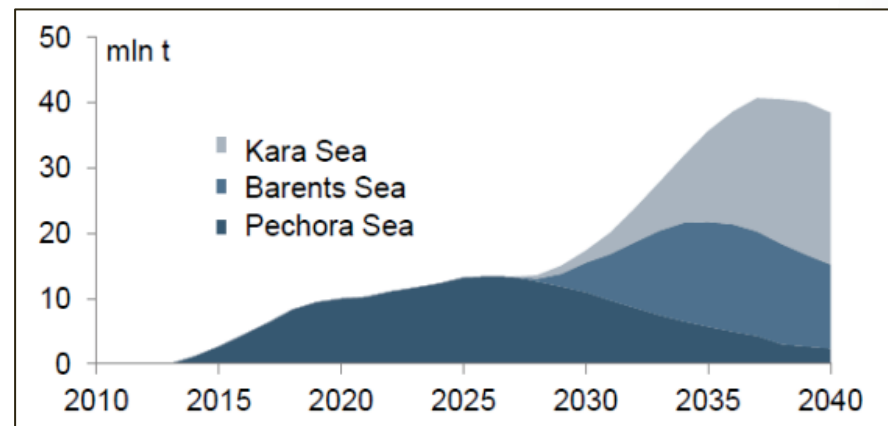
- Arctic exploration set to begin in August 2014
- Rosneft the leader, with huge acreage position
- JVs signed with ExxonMobil, Statoil and ENI
- South Kara Sea the initial focus, with IOC involvement vital
  - Technology
  - Experience
  - Funding
- Huge commercial and geopolitical significance
- Vital for Russia's long-term production profile

*Russia owns 60% of Arctic resources*



*Source: USGS analysis*

*1mmbpd of output estimated by 2035*



*Source: E&Y*

# Black Sea is an area of increasing strategic importance, with exploration and pipeline activity

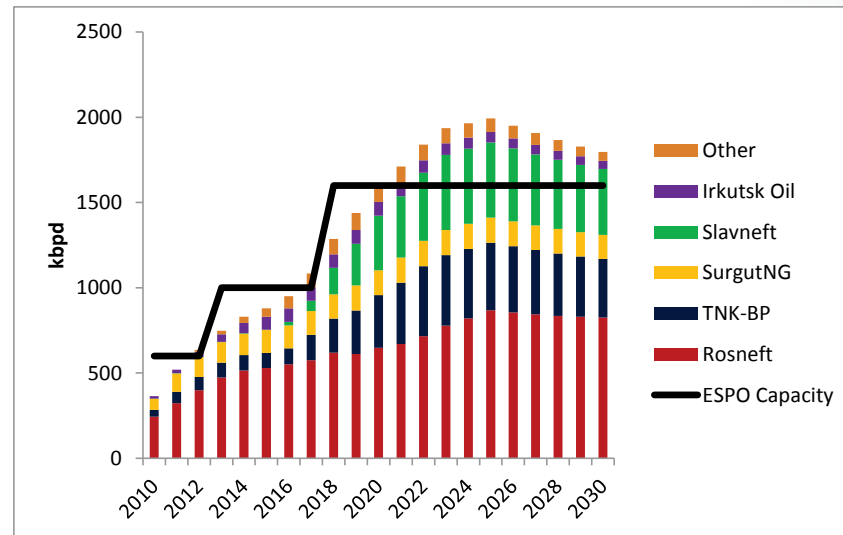


- Russia's involvement in Black Sea exploration has become a more sensitive issue
- The South Stream pipeline will become a major strategic asset partly funded by European companies and causing fierce debate with the EU

# Eastern partnership becoming a greater focus, with export sales and finance the key drivers

- Development of Russia's eastern regions a domestic priority
- Asia to become a vital source of extra export revenues
- Oil production and exports set to rise based around ESPO pipeline
- Gas export deal with China to catalyse eastern gas programme
- Foreign partnership focused on Chinese and Japanese companies
- IOCs involved in Sakhalin and could have a greater role to play as region developed

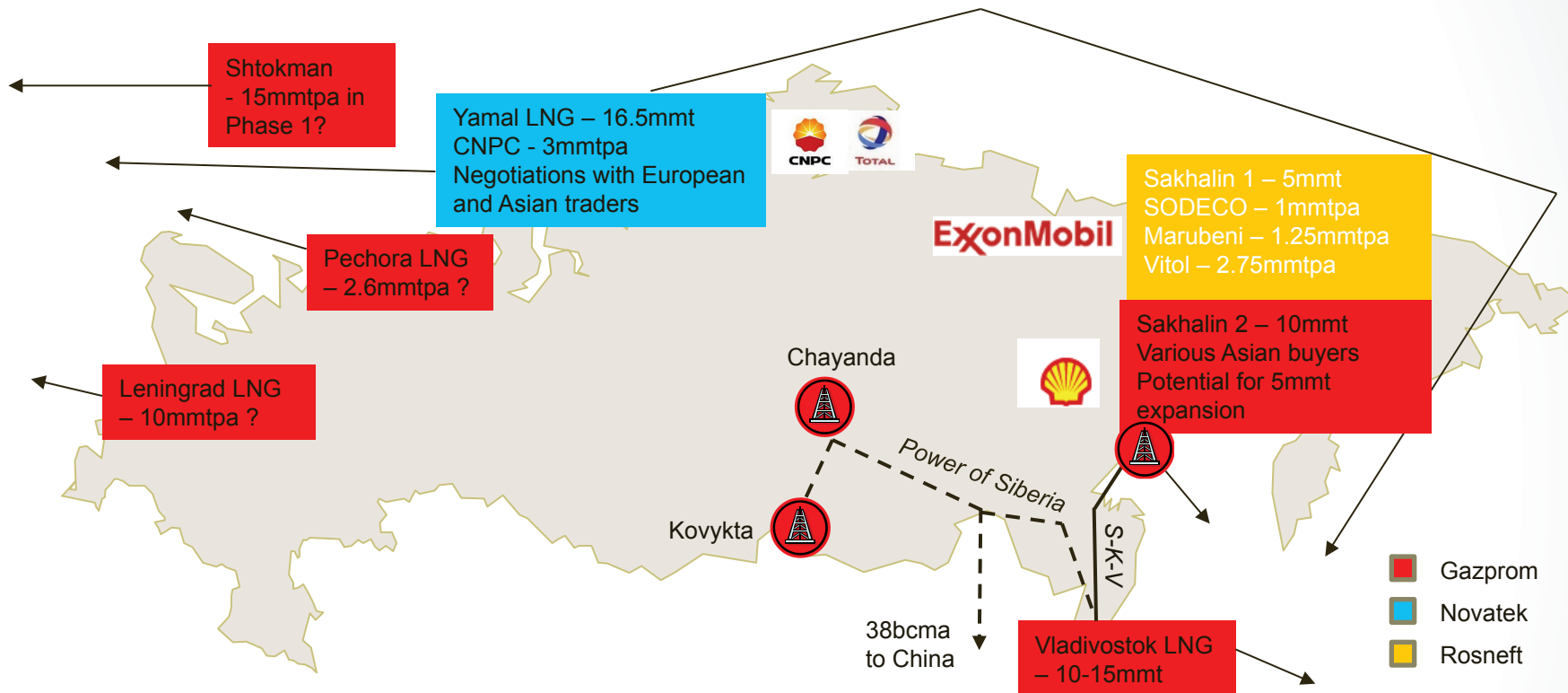
Eastern oil production to fill ESPO



Eastern gas programme to cost \$80-100bn



# LNG developments – technology, marketing and finance all needed from foreign partners

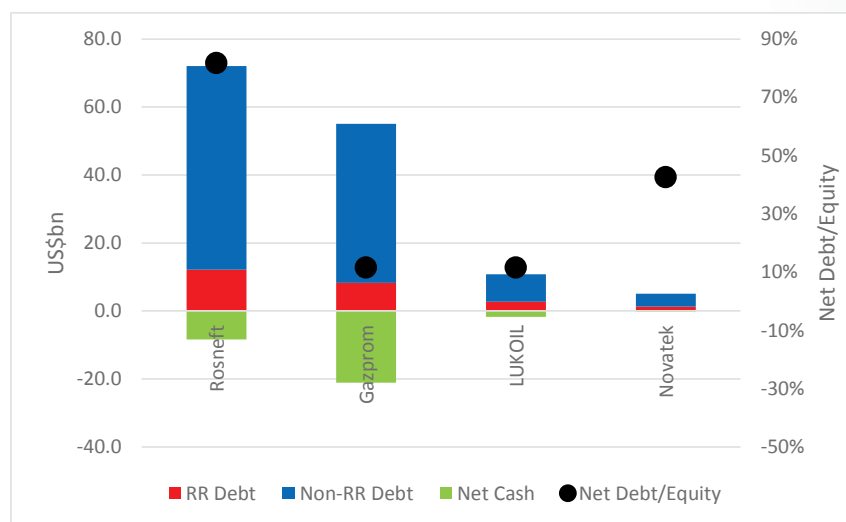


- LNG has become a priority in the gas sector as Russia seeks to confirm its role as a global player
- International partnership is vital to the development of new LNG schemes
- Gazprom is facing a challenge from domestic peers with IOC support

# Financing of projects will be a key issue

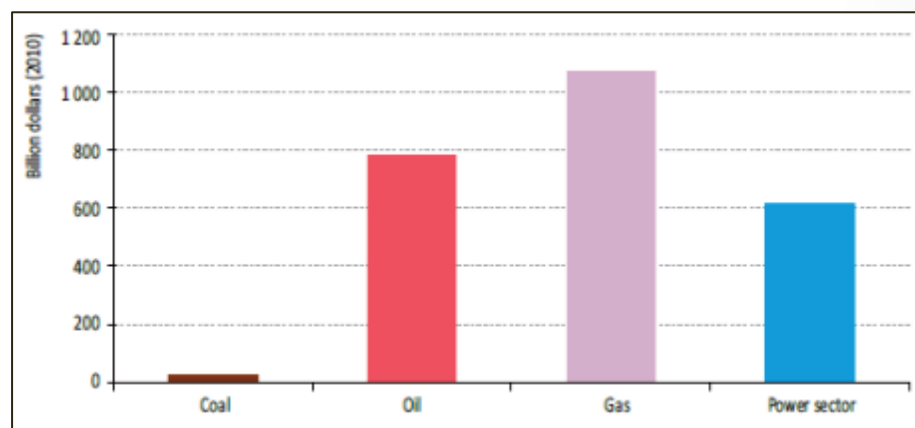
- Development of Russia's emerging regions implies huge capital expenditure
- Project financing will be a necessity
- A spread of international lending, IOC equity investment and state support will be needed
- Banks will always be more prepared to lend if partners have credibility and experience
- Political uncertainty clearly a key risk – IOC presence can offset this to an extent

Major ROC debt positions – Rosneft's burden is heavy



Source: Company IFRS accounts

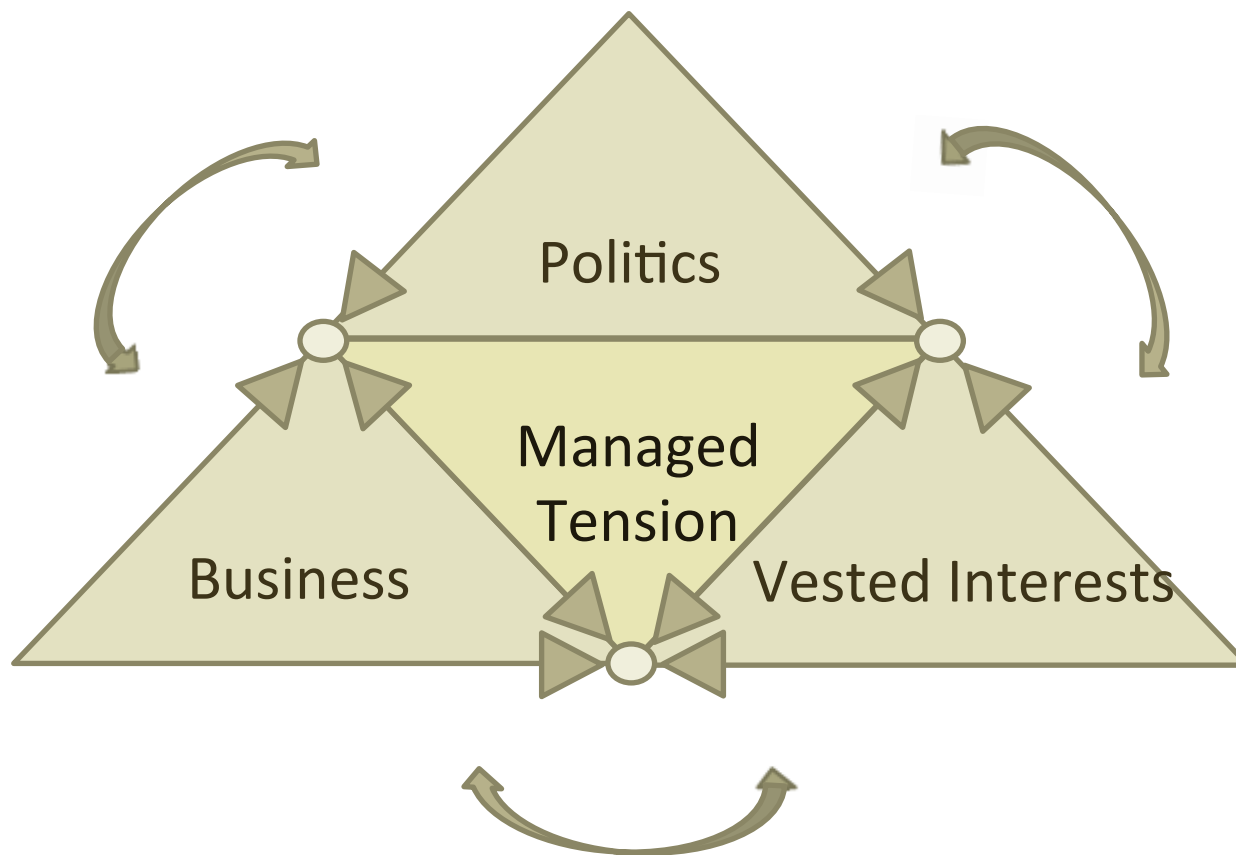
Almost \$2 trillion of investment needed to 2035



Source: IEA WEO 2011



# Russian Business Environment – The “Triangle of Tension”



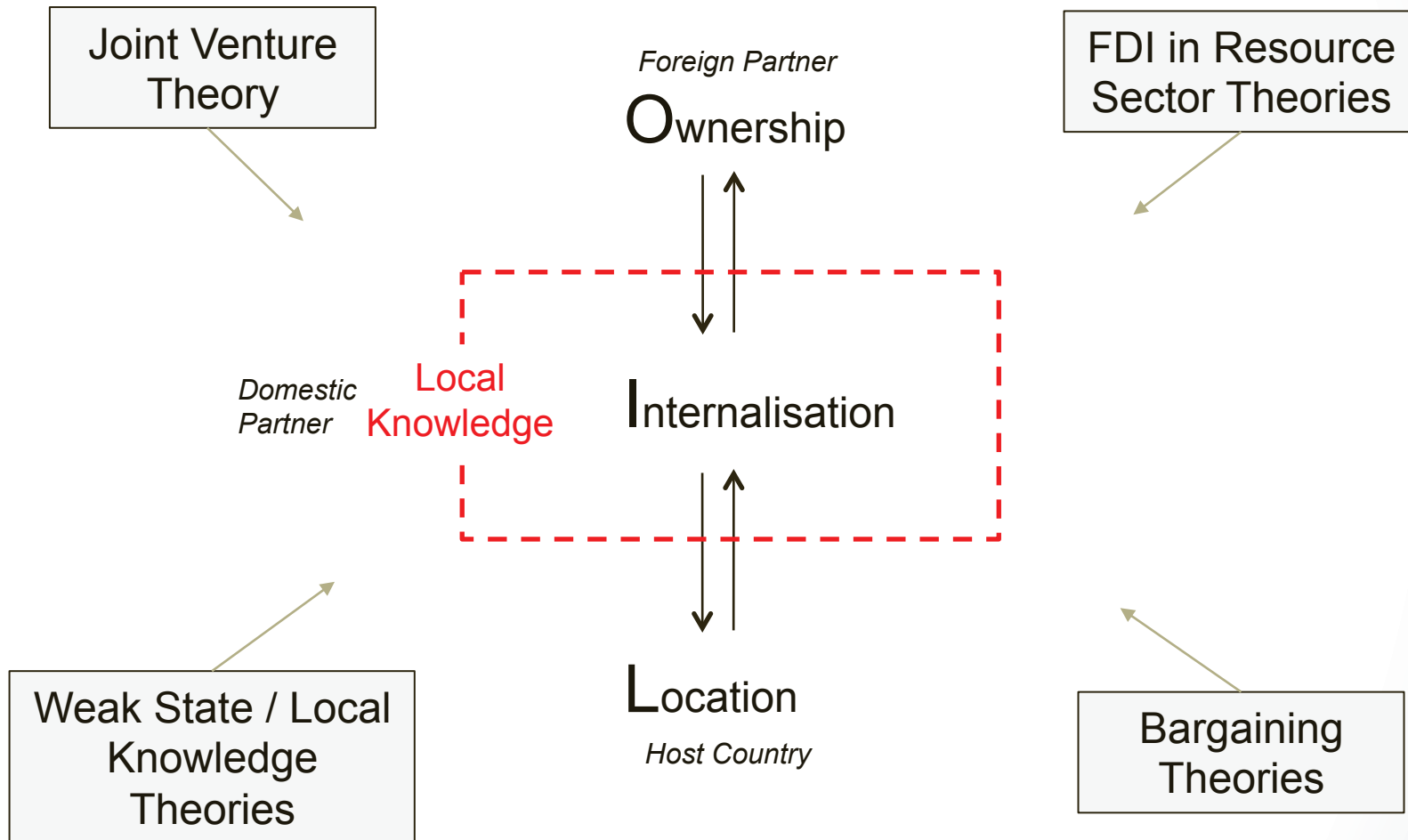
# Russian Business Environment

..... characterised by complexity and ambiguity:

- Factional and fragmented; managed tension between factions; trade offs but not always connected business and interests
- Tenacity – determined and persistent
- Confrontational and aggressive
- Conflict and mistrust are the norm
- Unconventional business model – not linear and not transparent
- ‘Win lose’ is preferred outcome

.....the partnership model in Russia is competitive - specifically competition for knowledge

# Theoretical context for FDI in a weak state environment



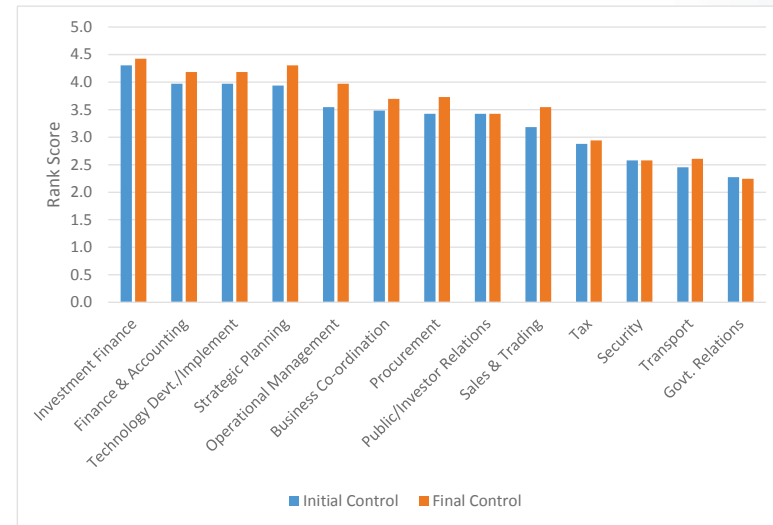
# Key Themes from Case Studies and Interviews

- **Key themes from 1990s included:**
  - Foreign partner brought a combination of technology, management skills and money
  - Domestic partner brought access, assets and local knowledge
  - Transfer of knowledge tends to be a one-way process
  - DP local knowledge is an asset to a JV but also a key risk for the FP
  - In any conflict over JV issues the DP normally wins
- **Interviews from 2000s confirmed that:**
  - The business environment for international partnerships in Russia has not changed dramatically over the past decade
  - Institutions remain weak and dominated by key individuals
  - Business outlook remains relatively short-term as faith in reliability of laws and regulations remains low
  - Status quo unlikely to change soon, as it benefits the domestic elite
  - Local knowledge and influence remain vital commodities
  - International skills and work-force not always welcome, which can undermine foreign partner position

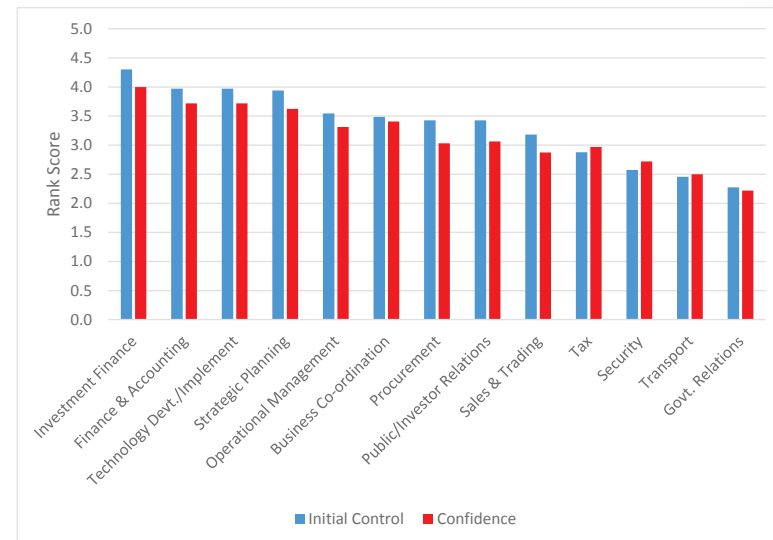
# Survey of partnerships provided objective confirmation

- Foreign partners in 33 joint entities surveyed
- Confirmed that domestic partner learning took place and was encouraged
- FPs learning identified through change of control over key responsibilities
  - No significant change identified
- Remained strong in original areas, made no progress on local knowledge issues
- No gain in confidence either
  - Related to internal partnership issues as no change in external environment
- However, there was a range of FP performance around this average

*FP initial and final control*



*FP control and confidence*



# More local knowledge = more success

## **Overall Model explains 61% of FP success**

*FP success = K + (0.46 x Increase in Local Knowledge) + (0.32 x DP Success) – (0.31 x State Influence)*

For every 25% increase in FP Local Knowledge his chance of success goes up by 12%

## **Joint Venture Model explains 58% of FP success in JVs**

*FP success = K + (0.63 x Increase in Local Knowledge) + (0.31 x DP Success)*

For every 25% increase in FP Local Knowledge his chance of success goes up by 16%

## **The Corporate Model makes a significant contribution to FP success on its own**

Joint entities using a corporate model are statistically more successful than normal JVs, but no other factor makes a significant contribution

# Managing Risk and Protection - Principles

- What you see is not what you get
- What is really happening vs. what you are being led to believe
- Understand interfaces and motivations – the real drivers
- Always triangulate politics, business and vested interests to build an integrated picture (better than 75%)....and develop a response
- Persistence is key to protecting yourself

## **Bottom line:**

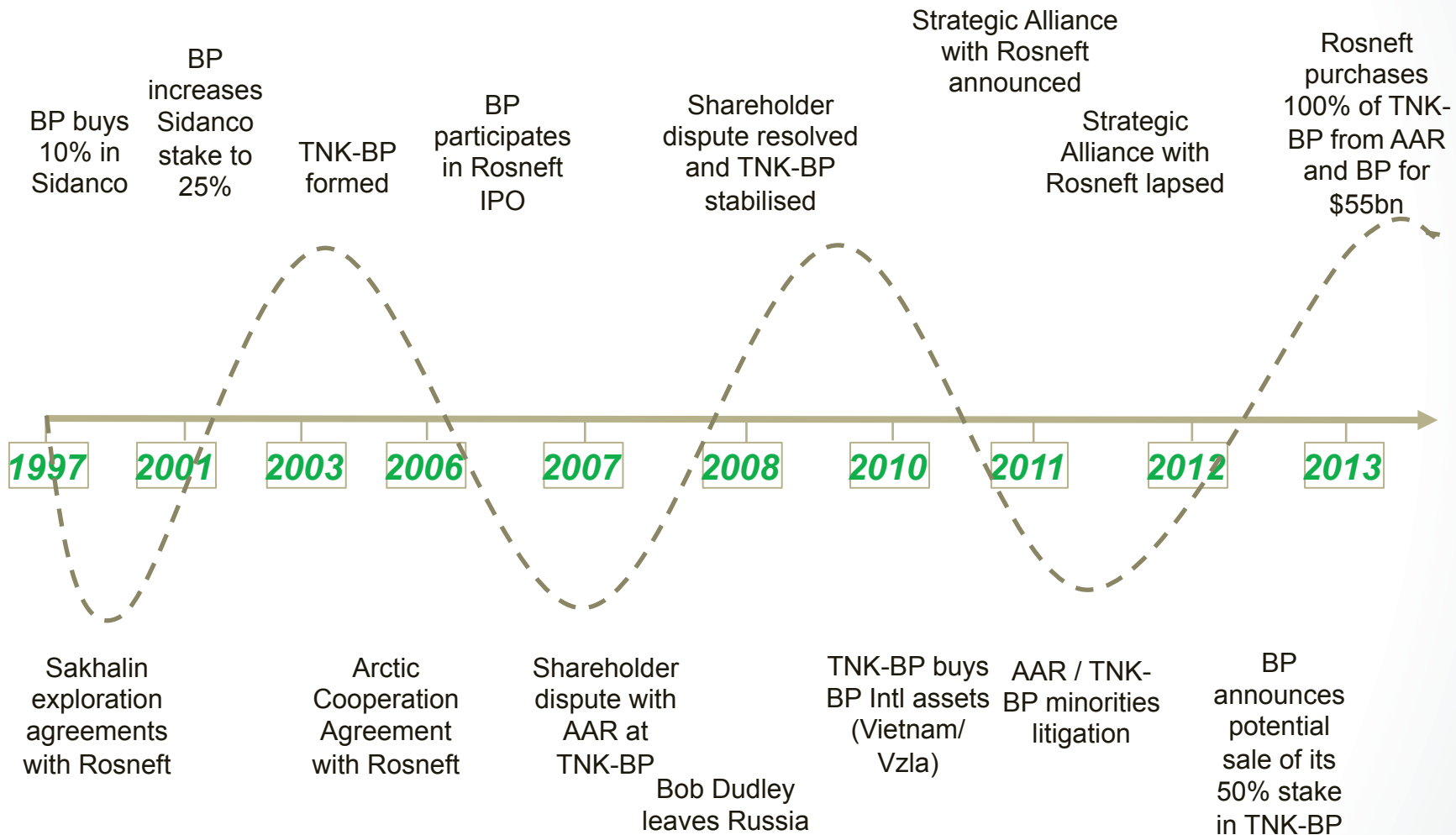
Difficult to manage and/or negotiate if you don't understand the drivers and what is really motivating a decision

# Foreign Entities in Russia – Common Mistakes

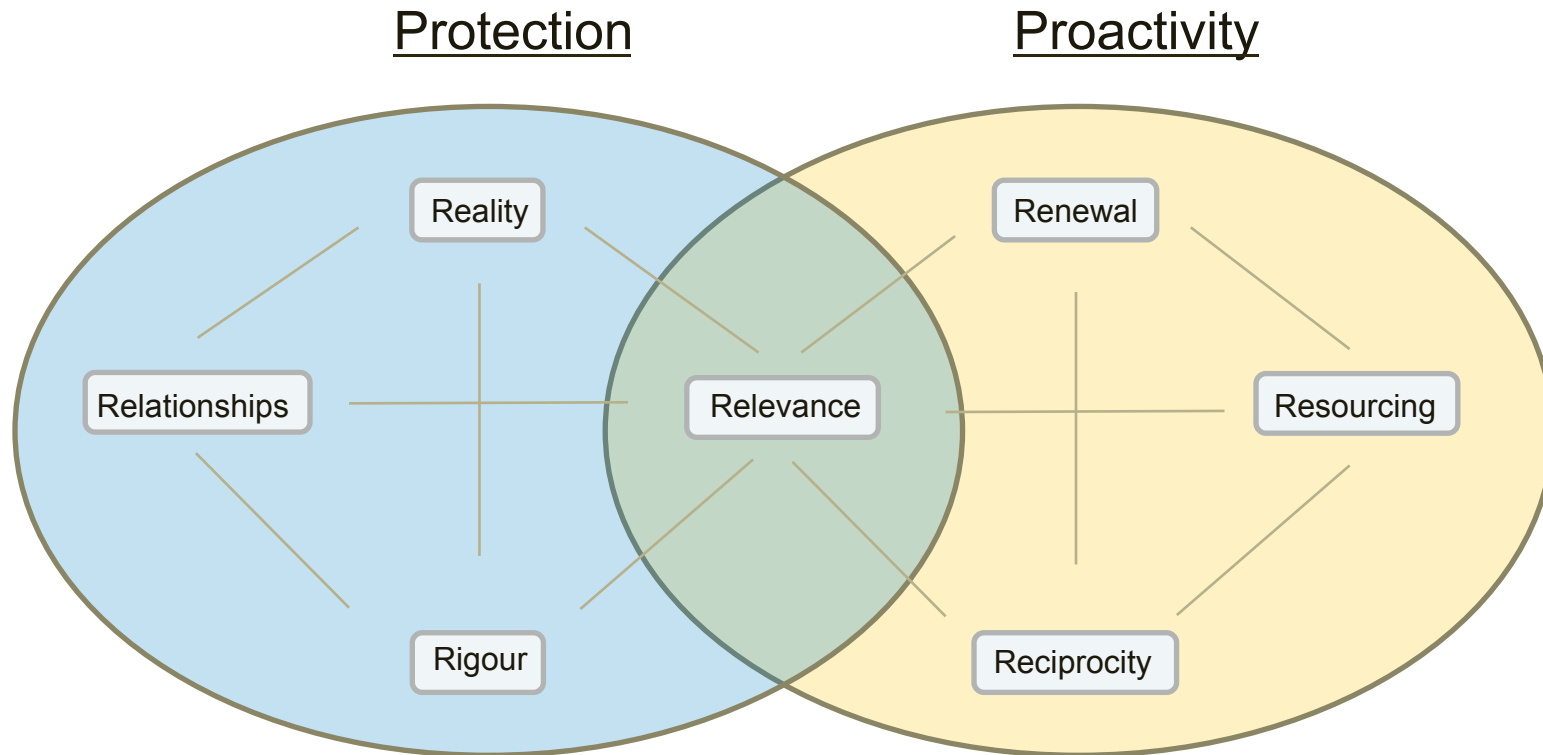
- Over-reliance on intermediaries who promise understanding of, and access to, key decision makers but who cannot deliver
- Overconfident senior leadership who underestimate the level of complexity and ambiguity
- Misunderstanding/ misinterpreting the signals due to poor intelligence – send and receive capability
- Quality of human resources you have on the ground in Russia – do they really have insight into what is happening?
- Lack of persistence in protecting and defending yourself
- Complacency and arrogance once you have established a foothold



# Key Moments in the History of TNK-BP



# The “7 Rs” Engagement Strategy



Everything revolves around Foreign Partner **Relevance**

# Conclusions

- Never underestimate the degree of complexity and ambiguity or be complacent – Russians have a strong sense of when and where a partner is weak – and they will fully exploit it
- Russian partnership model is competitive, specifically competition for knowledge
- In a weak state environment balance can only be maintained if a FP gains local knowledge
- It is vital to understand the business and political environment and your partner's key drivers as fully as possible
- This requires an integrated engagement strategy – 7Rs Model to ensure continuing relevance and balance in the relationship