A New Oil Giant

This seems to be the year for creating massive new oil companies. Earlier this year, BP merged its Russian business with Tyumen Oil Company (TNK) to create a new giant on the Russian market. Now, this week (April 21, 2002) Yukos and Sibneft have announced plans to merge. These plans have gotten even more notice in the press than the TNK-BP deal seemed to get. It certainly seems to confirm earlier impressions that the Russian oil industry is moving onto the world stage with vigor. (See Pan EurAsian's review of the TNK-BP deal.)

Ranking of Selected Oil Companies

International Companies[1]	Daily production (thousand bpd)	Reserves (million barrels)
ExxonMobil	2,496	11,823
Royal Dutch Shell Group	2,220	10,133
BP AMOCO	2,018	7,762
ChevronTexaco	1,751	8,668
TotalFINA Elf	1,597	7,231
ConocoPhillips	682	4,632
ENI	921	3,783
Russian Companies[2]		
Lukoil	1,522	14,577
Yukos	1,392	12,581
Sibneft	579	4,646
YukosSibneft	1,971	17,227
TNK	582	7,258
BP-TNK	1,100	10,500

Data sources
1. SEC Reports. Data include Proved Reserves of Condensate, Natural Gas Liquids and Crude Oil.
2. SEC Reports for Lukoil and Yukos. Annual Reports for Sibneft. BP-TNK from press reports

Pan EurAsian has not examined the economics of this transaction; not enough is known about it yet to make meaningful comments. In general however, we offer the following comments on the information assembled above.

1. The Russian oil companies, in terms of proved reserves, seem larger than even the largest of their western counterparts. However, this conclusion is erroneous. First, the numbers are not entirely comparable on a technical basis. Second, the economics of proving up reserves make it cheaper for Russian companies to do so. Western major oil companies are more likely to put the money into moving reserves from probable categories into proven categories when they need them, given the cost of doing so and the depressing effect tying up too much money on the balance sheet in reserves that will not be producing for some time to come. Therefore, it is not unexpected that the Russian companies would be showing more reserves than they might were they managing in a western environment. This will change in Russia with time.

2. Therefore, we believe that production levels are a more meaningful basis of comparison. It should be noted that this only compares upstream oil activities and pays no attention to mid-stream and downstream activities, in which the western companies are far more developed.
3. This is not to take away from the obvious weight of these new Russian companies. They are being noticed and heard from. This will only become greater in the future. Russia's petroleum reserves (now estimated at about 50 billion barrels) are some of the least well defined reserves left on earth. Some industry observers believe that the present level of Russia's reserves could increase to three or four times the present stated size.
4. The Russian oil industry is leading the rest of Russia's industries in adopting international accounting standards, including rapidly improving standards of transparency and corporate governance practices. The present actions of Russian oil companies are being conducted with far more transparency and accountability to the public than has been seen in Russia before. As this trend continues, and more international capital is finding its way into the Russian markets, there will be more and more deals done. Furthermore, it will not be too long before the "sovereign discount" disappears and the Russian government achieves investment grade rating on its international debt.

Conclusion

The TNK-BP deal set the stage; the YukosSibneft deal seems to confirm it. More deals are in the pipeline as the Russian oil industry consolidates further. Oil companies that have not yet looked carefully at Russia should do so: now. Russian reserves will not stay "cheap" for too much longer.