

A New Frontier – West Siberia

It seems that, for the first time in Russian history, Siberia becomes a destination of choice. It is an area with great promise for oil and gas exploration and development. Foreigners are not excluded. The game is just beginning.

An article in the January 15th *Kiplinger Letter* notes Russia's proven reserves are large, but that "the odds are Russia has reserves that match Saudi Arabia's 259 billion barrels." According to a recent presentation by Yukosⁱ, the largest Russian oil producer, Russia's proven reserves of about 50 billion barrels could double in the next ten years. Most of this increase will come from western Siberia and the Russian Shelf. Whether Kiplinger is right, or is just a little over-exuberant, remains to be seen. Even if the Lukoil projection is more realistic, the growth prospects are remarkable. The starting point is as follows.

World Oil Reserves

(barrels of oil X 10⁹)

Selected Countries

Saudi Arabia	Iraq	Russia	United States	Total World
263.5	112.5	48.6	21.8	1,051.2

Source: World Energy Council, proved recoverable reserves, end 1999.
See www.worldenergy.org

The Russian reserves were producing about 11 million barrels of oil per day (mmbo/d) during the 1980s, and with the collapse of the Soviet structures, production reached a low of 6 mmbo/d in the mid 1990s. Production has increased somewhat to nearly 7 mmbo/d in 2001. Of that production, slightly less than half is exported.

All of this has significant political and economic meaning for the world. Because of the rising tensions in the Middle East, western governments are seeking to diversify away from the dependency that has grown on the Middle Eastern producers. Russia and the Caspian region have been a significant part of this diversification.

The major oil companies have already tuned into this opportunity and have established significant Russian and Caspian presences. Does this mean that smaller independent oil companies should not consider Russia? No.

There are more than 100 smaller oil companies already operating in western Siberia, over and above the major Russian companies (Yukos, Bashneft, Lukoil, Rosneft, Sibneft, Slavneft, SIDANCO, and TNK). Except for the largest of the Russian oil companies, access to capital is difficult and access to technology is even more difficult. The door is open for western independents who wish to enter the market.

There are risks, of course, but we believe the climate is improving. Russia is still in the process of reforming a centrally planned, state-owned infrastructure into a western style capitalistic system. Licensing procedures and taxation remain problems. The physical constraint on exports, coupled with the monopolistic position of the oil pipeline ownership (Transneft), means that the price at the wellhead is below world market prices by more than a straight netback calculation would indicate. However, lifting costs in western Siberia are estimated generally as less than \$3 per bbl.

However, these risks are recognized in the market prices for Russian oil reserves; the recent acquisition of Slavneft valued the company at \$2.5 billion, and included estimated (but not all proven) reserves of over 10 billion barrels of oil, mostly in western Siberia. In short, the cost to enter the Russian oil production business is not high in western Siberia.

Russian oil production remains at low levels compared to historic figures. Domestic consumption of oil is also low at 3.5 million barrels per day. Considering that the population of 150 million people, this is well below the consumption rate of the US with 19.6 million barrels per day. Clearly, as the Russian economy begins to approach western levels of development, the consumption of oil will increase dramatically.

Russia exports about 3 million barrels per day of its production. At present the export facilities are physically limited constrained and serve mostly the former COMECON countries of Central Europe. Various projects are underway to expand Russian export capabilities and to give Russian oil exporters direct access to the international seaborne trade. A small amount of crude was exported to the US in 2002, but new facilities will be needed to build that business significantly. Plans are being developed and implemented to give both Russian and Caspian producers better access to deep water export facilities.

The summary below shows that, although there are well over 100 independent oil producers in Russia, a few large and integrated oil companies dominate the business.

Production of Oil in Russia

selected major producers

October 2002

Company	Production in '000 tons	% Total Russia
Bashneft	1,012.5	3.0%
Lukoil	6,418.2	19.1%
Rosneft	1,382.9	4.1%
Sibneft	2,455.2	7.3%
SIDANCO	1,412.2	4.2%
Slavneft	1,428.0	4.2%
Surgutneftegaz	4,322.7	12.8%
Tatneft	2,090.9	6.2%
TNK	3,321.3	9.9%
Yukos	6,440.9	19.1%
Total	30,284.7	90.0%
Total Russia	33,665.0	100.0%

Although this represents significant concentration, it should not be taken as a discouraging factor. The market is far from mature. Many of the independents are recently chartered and have significant, but undeveloped, concessions. They lack the capital and expertise necessary to develop those reserves. Indeed, some of these small independents are already foreign companies that have entered the market. Indications are that they are doing better than had been expected.

In summary, Pan EurAsian believes that the Russian oil market is one of the best expansion possibilities in the world for second tier western companies that have not already entered that market. As with any national market, Russia requires some study to learn how, and how not, to enter the market. We believe that those who enter now in a careful and judicious fashion will be well rewarded.

We also believe that significant opportunities also exist for financial investors.

Pan EurAsian specializes in working with energy industry clients to develop, and implement, strategies and plans for entering the emerging economies of Central and Eastern Europe. We welcome inquiries from potential clients who may wish to examine the Russian market and to develop an approach to this market.

ⁱ See: www.isv.uu.se/IWOOD2002/ppt/pptLR.ppt