Investment and export opportunities for Russian companies in oil and gas projects abroad: asset swaps as a method of developing direct foreign investment

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RPGC 2013
Moscow, June 25th
New severe environment for the energy projects

• Changing global environment, shifting centres of economic and energy consumption, changing trade flows, repartition of the energy markets
• Higher political and social instability
• Higher uncertainty and volatility
• Hard budget constraints
• All new projects deal with considerable technological challenges, delays and cost overruns
• Severe requirements for the quality of the project management

All projects have to overcome or at least mitigate the following risks:

Geological risks: volumes of oil/gas
Technological risks
Environmental risks: strict environmental regulation, protests
Price risks: oil/gas prices fall
Financial risks: tax changes, adverse exchange rate changes
Investment risks: delays, cost inflation
Political risks: contract re-negotiation, withdrawal of assets, border disputes, sanctions, war
Tremendous shifts on the liquid fuels market

More than 60% of incremental demand for liquids will come from the developing Asia. More than 70% of the incremental supply will be covered by different types of unconventional liquids. Unconventional oil (shale oil, tar sands oil, etc.) will reach 16.4% of total production - 837 mln tons by 2040 – and dramatically change all structure of the global oil trade and pricing.
Trade flows in the oil market will change fundamentally by 2040: export market niches will narrow by 275 m tons for key producers, in comparison to 2010.

Main directions of oil flows, million tons

Source: ERI RAS
Gas markets are providing huge new opportunities

By 2040 global gas demand will increase by 60%, mainly driven by the power sector, where gas is an ideal environmentally friendly fuel to cover growing demand for flexible electricity supply. Another extremely promising application is gas use for the transportation sector – it has smaller footprint for lower price. Gas supply additions will be mainly provided by the new conventional field development. LNG will demonstrate much higher growth rates than pipeline transportation.
For the next three decades, the main focus of the international gas trade will be Asia which will increase its net imports by nearly 500 bcm by 2040.

Inter-regional gas trade in 2040, bcm

Source: ERI RAS
Internationalization of the energy companies is one of the goals of the Russian Energy Strategy - 2030

## External Russian energy policy – Key aspects

Major political measures and goals are divided in time in three clearly defined phases till 2030

<table>
<thead>
<tr>
<th>Now</th>
<th>2015</th>
<th>2020</th>
<th>2030</th>
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</thead>
<tbody>
<tr>
<td><strong>Phase I</strong></td>
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<tr>
<td>Development of exchange of energy assets as well as other forms of international co-operation</td>
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<td>International agreements on government level which promote the interests of Russian energy companies</td>
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<td>Information as well as political and economic support for the Russian energy companies abroad</td>
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<td><strong>Phase II</strong></td>
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<td>To strengthen Russia’s position in regional energy cooperations (EU, Asia-Pacific, Middle East, Africa, Central and South-East Asia, Latin America, China)</td>
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<td>Encourage cooperations between Russian companies and national corporations</td>
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<td>Strengthening the position of Russian nuclear power in world markets along the entire value chain</td>
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<td><strong>Phase III</strong></td>
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<td>Establishment of global production and processing chains for the supply of energy resources</td>
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<td>Labor division and efficiency increase in production</td>
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<td>Establishment of stable presence of a Russian energy company in the top three leading energy companies</td>
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Why are Russian companies interested in foreign projects?

- New profitable investment opportunities
- Entry to the new premium markets
- Risk management – portfolio of projects needs balance, so that risks in one project are offset by others
  - A mix of frontier exploration and known field development (greenfield vs. brownfield)
  - A mix of oil and gas
  - A mix of upstream, midstream and downstream
  - A mix of geographical locations to broaden political risk and to access different markets
- Access to the new vast resource base
- Access to the new technologies and management expertise
- Synergy from global operation
Most of the internationalization strategies of Russian companies are opportunity driven with sometimes doubtful value created for the company, the main value brought to the recipient country is capital.

Oil and gas exploration hot spots

Source: CGES
What can Russian oil and gas companies propose to the counterparties?

<table>
<thead>
<tr>
<th>COUNTERPARTIES NEED</th>
<th>RUSSIAN COMPANIES CAN PROVIDE</th>
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<tbody>
<tr>
<td>Capital</td>
<td>✓ Capital</td>
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<td>New technologies and expertise</td>
<td>Some technologies</td>
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<td>Access to the final market and to distribution channels</td>
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<td>Skills:</td>
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<td>Complex governance and project setting that involves IOC,</td>
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<td>and different types of NOC</td>
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<tr>
<td>Collaborative project development process</td>
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<td>Management of stakeholders and the mitigation of political</td>
<td>Political support of the stakeholders in the certain countries;</td>
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<td>and social risks in a complex project</td>
<td>regional and cultural proximity</td>
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<td>Management of complex global subcontracting hierarchies</td>
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<td>Selecting, engaging and/or managing the correct joint</td>
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<td>ventures agreements that deliver both commercial success</td>
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<td>and protect the company against costly dispute</td>
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Asset swaps as a method of developing direct foreign investment

Asset swap is a transaction in which companies agree to mutually transmit ownership rights to previously matched assets without exchanging money.

Goals

- Vertical integration, geographic diversification, business diversification, horizontal integration (building secured supply chains)
- Policy-related incentives
- New opportunities within the markets
- Entry into new markets while securing existing markets
- Search for profitable investment while mitigating investment risks
- Dealing with the limited financial capabilities during the crises

In the situation of mutual mistrust, lack of financial confidence and resources, asset swap mechanism helps to provide stable flow of energy and capital and in most cases helps states enhance their respective energy securities.

Asset swap deals:

- E.ON; Enel; GDF Suez; Iberdrola; Edp; Eletrobras; OMV; Statoil; Petrobras; Petronas; Saudi Aramco; CNOOC; CNPC; Sinopec; Gazprom; Novatek; Likoil; Rosneft; Inter-RAO UES; Rosatom.

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