

2014 Russian Oil & Gas
Outlook Survey
Russian Oil & Gas
Sector Overview



Introduction

This marks the eighth consecutive year in which Deloitte CIS has conducted a survey among the directors and leading specialists at state and private Oil & Gas companies at year end. The purpose of the survey is to recognise the interim results of the work of the entities in the sector, the results of their ongoing activities and the potential for industry development in the forthcoming year.

Despite the positive dynamics of demand for hydrocarbons and the current tendencies of industry development, in 2014 the majority of companies in the Oil & Gas sector are not likely to see any changes to their core asset portfolio. Companies are likely to make investments to develop hydrocarbon fields, increase the technological efficiency of refining and the sale of oil products, and general industrial modernisation, required due to the adoption of amendments to the Euro-4 technical regulations. Thus, both external borrowings and companies' own funds are considered as sources of financing by Oil & Gas companies.

For most industry representatives, the main areas of operation over the next year will be the implementation of processes and planning and budgeting systems, logistics cost optimisation and headcount optimisation.

That specialists have high expectations regarding state regulation of the industry is not surprising: almost a quarter of the respondents noted the need to stimulate geological surveillance activities and the MET differentiation for hard to recover reserves. In addition, 13% of respondents stressed the absolute necessity to conduct an overhaul of Russian legislation regarding activity on the Russian continental shelf.

Please see below for more detailed answers given by the survey participants. We sincerely hope that the results of our survey will be both interesting and useful to you.

We are grateful to everyone who shared their opinions with us on the development of the Russian Oil & Gas industry.

We would like to wish our readers a successful year 2014 filled with prosperity for them and their businesses!

Elena Lazko
Partner
CIS Oil & Gas Group Leader



Survey objectives

Annual review of the industry in the Russian Federation

Key Elements:

- Assessment of demand for oil and gas
- Assessment of state regulation
- Key problems facing the industry
- Asset portfolio management
- Future plans with regard to key activities

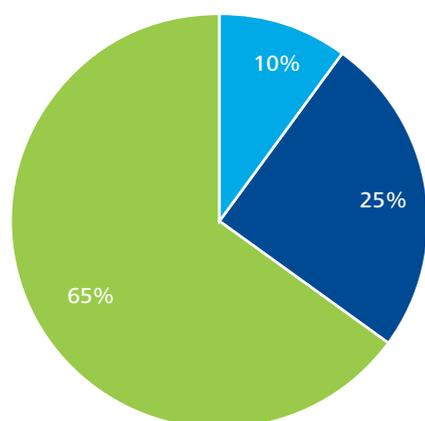
Is the industry facing stagnation or stability?



Our respondents

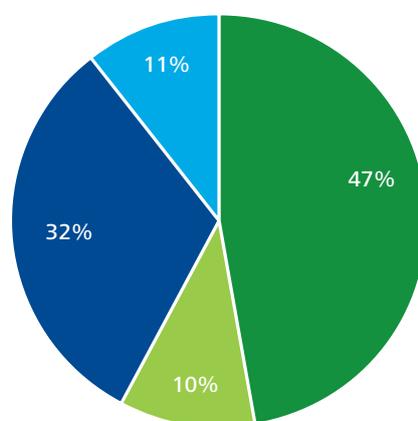
We surveyed executives at various levels (senior executives, heads of divisions, departmental heads, etc.) involved in hydrocarbon exploration, production and processing. The survey covers large local and international, vertically-integrated companies and independent small and medium-sized businesses.

Your company is:



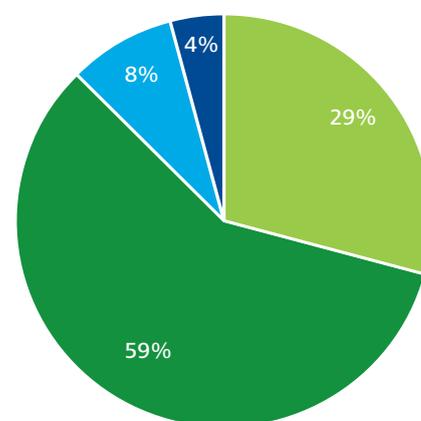
- A public company
- A private company
- A state-owned company

The consolidated annual revenue of your company is:



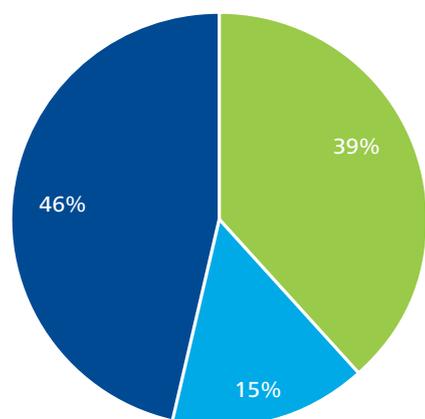
- Above USD 15 billion
- Between USD 1 billion and 15 billion
- Between USD 500 million and 1 billion
- Below USD 500 million

Your operational activities include:



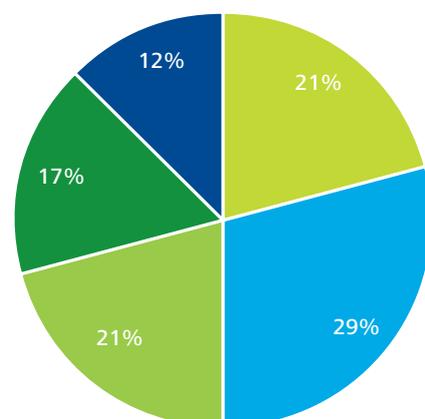
- Processing only
- Production and processing
- Production only
- Service company

Your position at the company:



- Head of a department or function
- Senior manager
- Head of a business unit, manager

Your functional area:



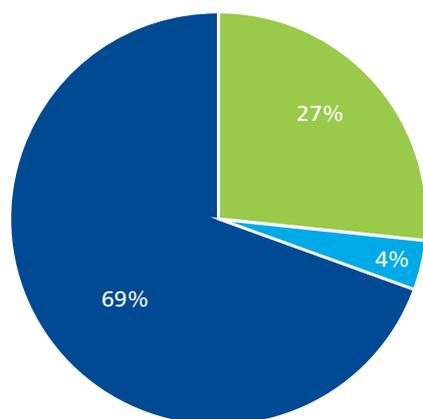
- Finance and planning
- Strategic management
- Operational division (extraction, processing and sales)
- HR management
- Senior management

2014 Russian Oil & Gas Outlook Survey

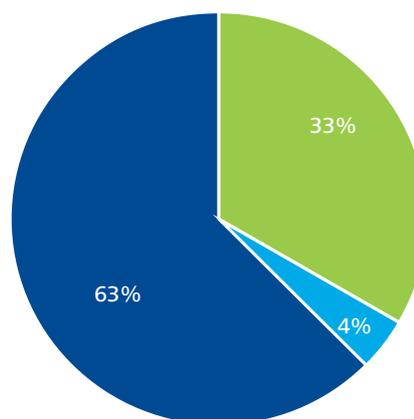
Change in demand for oil and gas on the domestic and global market over the next 5 years

- Increase
- Remain the same
- Decrease
- Don't know

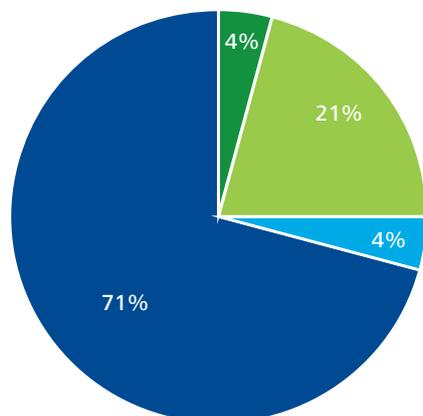
Domestic demand for oil will:



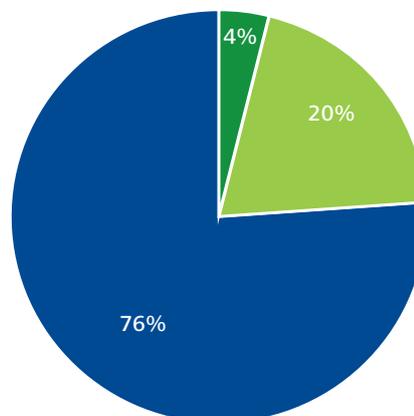
Domestic demand for gas will:



Global demand for oil will:



Global demand for gas will:



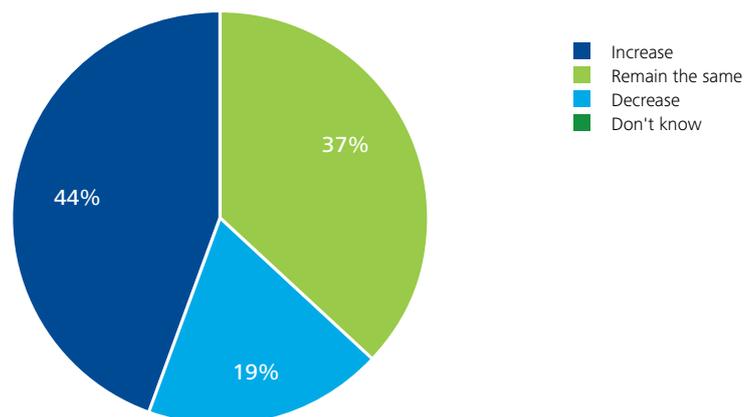
In 2013 respondents were just as optimistic about assessing demand for oil and gas, both in Russia and globally, as they had been a year before.

Thus, 69% of the respondents (compared to 60% in 2012) believe that demand for oil on the Russian domestic market will continue to grow in 2014. About a third (27%) of the respondents believe that demand will remain at the high level typical of this year. However, 4% of the specialists believe that demand for oil in Russia will go down. Forecasts for the Russian gas market are virtually identical: more than 60%

of respondents forecast growth on the domestic gas market, 33% anticipate that demand for gas will not change in 2014, and 4% think decline in demand for gas is possible (there was no such answer last year).

The number of respondents that believe that global oil and gas demand will grow has decreased to 71% and 76%, respectively (compared to 77% and 86% last year). About 20% of the respondents reckon that the global consumption of oil and gas will stay unchanged (in 2012 this opinion was shared by 15% of participants with respect to oil and 7% with respect to gas).

In 2014, oil prices will:



Most of the 2012 respondents' expectations regarding changes to oil prices came true: at the end of the year 40% of the participants expected oil prices to stay at current levels in 2013, 40% forecasted a decline, and 20% expected growth.

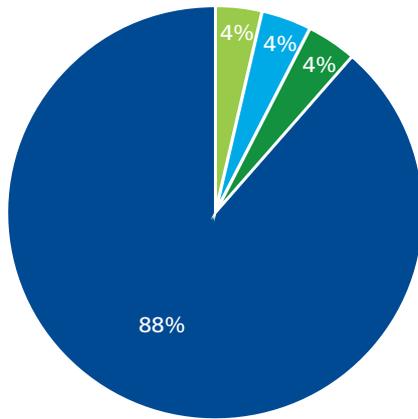
In the period from January to November 2013 (i.e. 11 months of 2013), the average price of Brent grade oil was USD 108.4 per barrel, a decline of 3% from the same period of 2012.

For 2014, almost half (44%) of respondents forecast oil price growth, 37% believe that prices will stay at the 2013 level, and only 19% (2013: 40%) anticipate a decline.

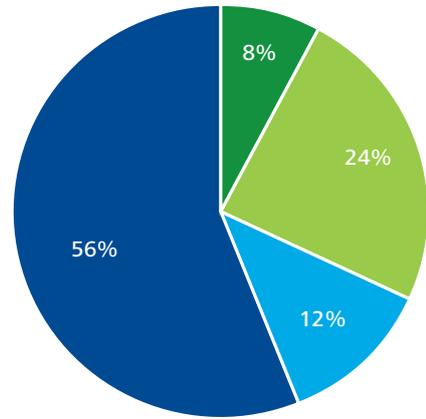
Capital market – five-year outlook

Capital demand in the oil and gas industry will:

- Increase
- Remain the same
- Decrease
- Don't know

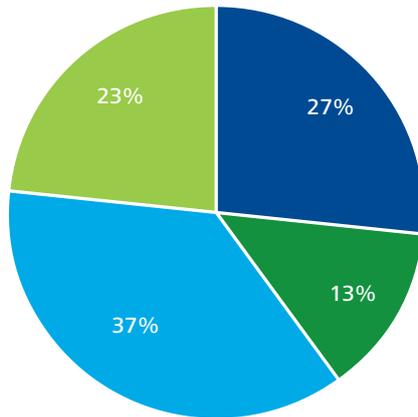


Inflow of capital into the Russian oil and gas industry will:



The primary source of financial investment for the Russian oil and gas industry will be:

- Internally available funds
- Shareholders' capital (IPO, involvement of strategic/financial investors)
- Loans and borrowings
- Don't know



Most specialists believe that, over the next few years, the capital demands of companies in the Russian oil and gas sector will only grow

As in 2011 and 2012, most specialists believe that, over the next few years, the capital demands of companies in the Russian oil and gas sector will only grow (in 2013 88% of the respondents were of that opinion, compared to 93% in 2012 and 91% in 2011). Another 4% of the respondents forecast that the required volume of capital investment in 2014 will be the same as in 2013.

These forecasts are based on the following market trends:

- The depletion of traditional light oil reserves and the resulting further development of the Russian mineral base in remote areas with harsh climates (including the Arctic shelf), requiring the use of expensive and sophisticated equipment
- The deterioration of equipment used in oil production and processing, resulting in significant investment being required to upgrade it.

More than half (56%) of the respondents expect an increase in the flow of capital in the Russian oil and gas sector over the next year, whereas only 50% of participants gave the same forecast for 2013.

Almost a quarter (24%) of the respondents believe that the volume of investment into the Russian oil and gas sector will not change, and 12% anticipate a decrease in the inflow of capital (compared to 29% last year).

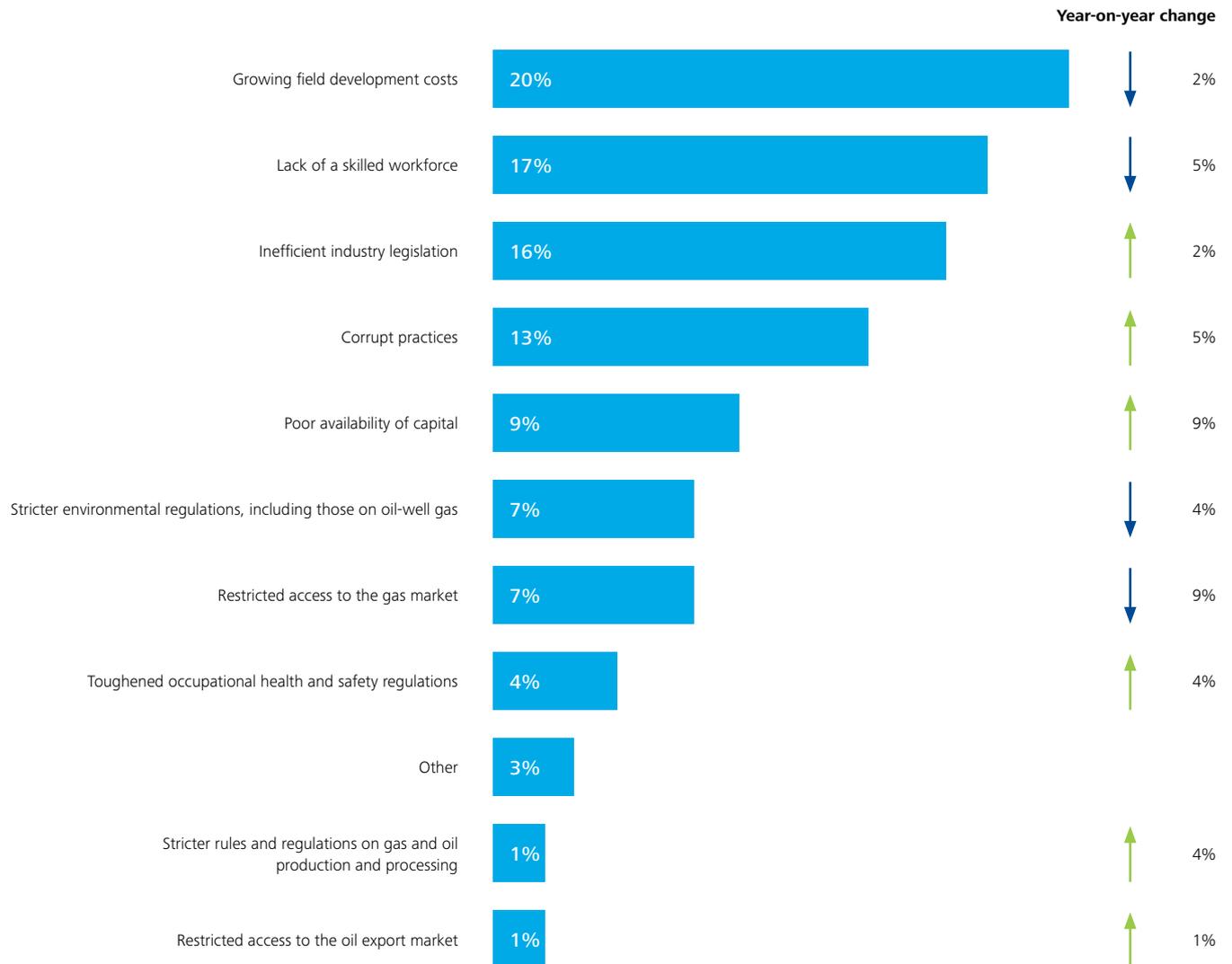
This shift in the specialists' opinions is likely to be due to the fact that oil companies have to finish upgrading their processing facilities by 2015 in order to enable the production of more environmentally-friendly fuels (the production of gasoline and diesel fuel of Euro-2 standard is permitted until the end of 2012, Euro-3 until the end of 2014, and Euro-4 until the end of 2015). Moreover, it is no secret that Russian oil and gas companies are in need of significant investment, and in the forthcoming years their capital needs will only grow.

This year, the structure of sources of capital has changed significantly as compared to 2012: whereas last year exactly half of the respondents were ready to consider third-party loans as the key source of capital, in 2013 this figure went down to 37%.

This significant shift may be due to the interest that arose among companies in the industry in increasing the size of their share capital, both through IPO and through finding strategic and/or financial investors, an option being considered by 23% of the respondents.

Like last year, a quarter of the companies plan to finance large projects from internal sources (2013 – 27%, 2012 – 21%).

Oil and gas sector – major problems



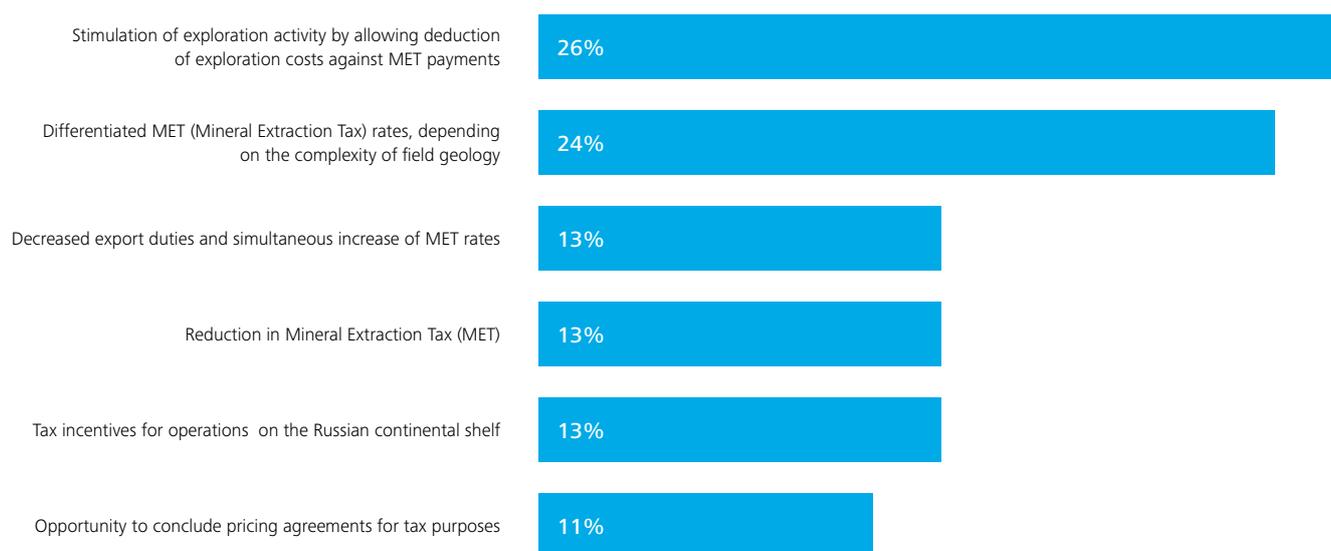
Similarly to 2011 and 2012, increasing field development costs are at the top of the list of the most significant challenges faced by oil and gas companies: this issue was noted by 20% of the respondents.

The Russian market is also affected by trends related to new technologies and new approaches to extracting and processing hydrocarbons. As may be seen from the chart, the lack of a skilled workforce is the second most important problem for companies (17%).

More than a quarter of the interviewed industry experts mentioned underdeveloped industry legislation (16% of the respondents) and a significant level of corruption (13% as compared to 8% a year before).

Among other problems, the survey participants noted difficulties in accessing capital (9%), toughened environmental legislation (7%), and difficulties in accessing the natural gas sale market (7%).

The tax benefits and tax adjustments that the industry will most benefit from are:



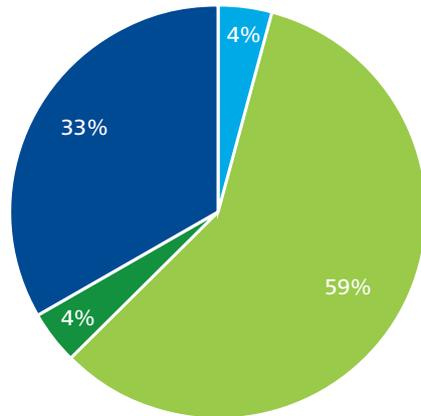
The need to actively develop the Russian mineral reserve base, including in remote areas such as Arctic shelf, provides an explanation for the prevailing position within the industry that measures such as incentives for geologic exploration activity (26% of the respondents), differentiation of MET for hard-to-extract reserves (24% of the respondents), and development of Russian legislation as it relates to the incentives for Russian continental shelf operations (13% of the respondents) are highly effective.

Also, echoing last years' responses, survey participants note, among meaningful incentives, a reduction of export duties (13% vs. 28% a year before) and beneficial MET rates (13% versus 15–18% in 2012).

Your headcount in 2013 has:

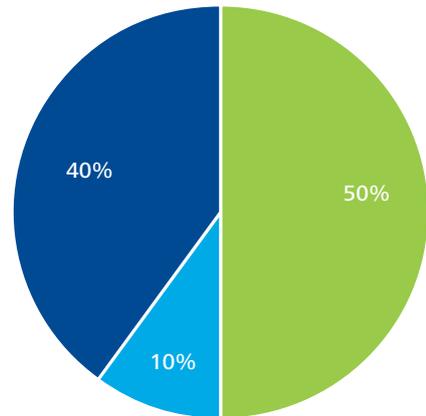
- Increased
- Remained the same
- Decreased
- Don't know

Headquarters
Management

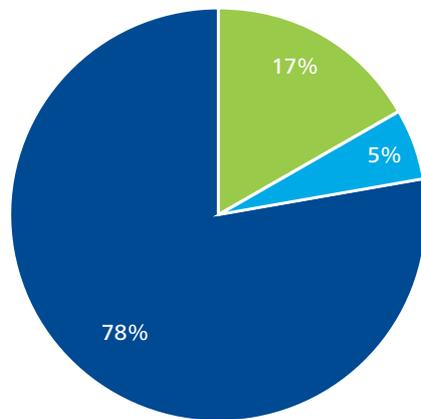


Production units

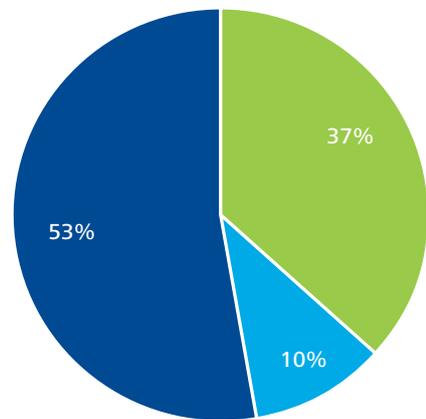
Management, professional and administrative staff



Professional and administrative staff



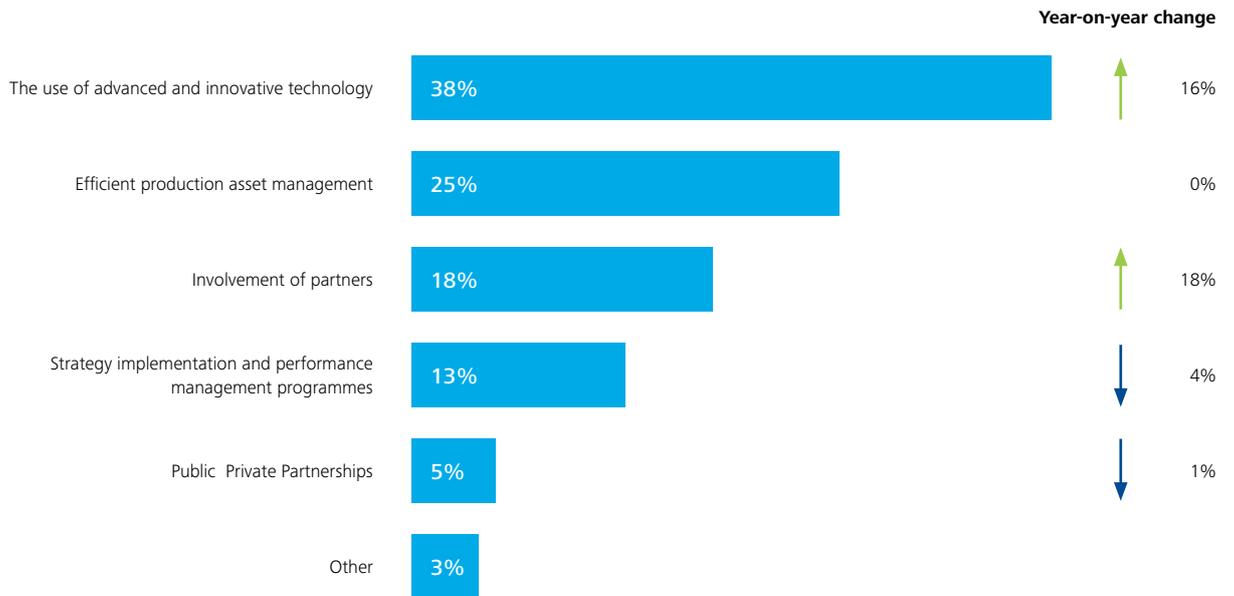
Manual workers



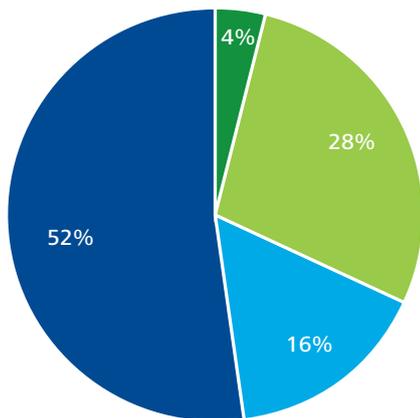
This year, 33% of the respondents noted an increase in the number of management-level personnel (2012 – 43%), and 78% in the number of specialists and white-collar personnel (69% last year) at their head offices. In 2013, 58% of the respondents said there were no changes to the number of management level-personnel (2012 – 43%), and 17% said the same about the number of specialists (23% last year) at their head offices.

10% of the respondents noted a reduced headcount in their production divisions at manager, white-collar and blue-collar level. For comparison: last year, companies' production divisions reduced the number of staff by 29% at manager and specialist level and by 14% at blue-collar level.

Strategic initiatives which maintain competitive advantage



In 2013, your production assets:



- Increased
- Remained the same
- Decreased
- Don't know

The factors of retention and increase of competitive advantage, as noted by most respondents, were the same as last year and included the implementation of the latest technology and innovation (22%), effective management of the asset portfolio (25%) and the implementation of performance management programmes (13%). Public-private partnership is only important to 5% of the respondents.

As in 2011 and 2012, companies continue to build up assets after a turbulent 2009: more than half (52%) of the survey participants spoke about plans to extend their asset portfolios. More than a quarter (28%) of the respondents, in turn, noted that they planned to keep their portfolios at the level of the current year (a year before, 14%).

Asset Portfolio

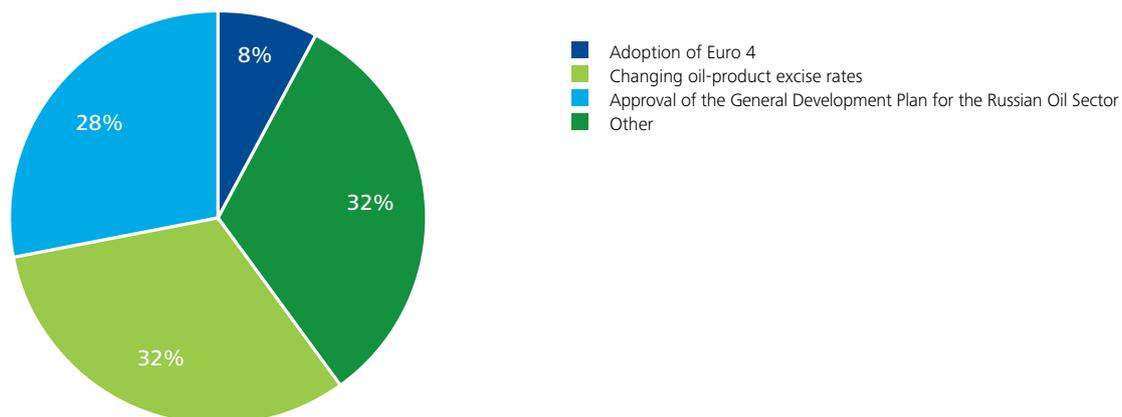
What plans does your company have for asset management in 2014?



In 2013, most respondents do not plan to change their asset portfolios (38%); however, a significant portion of companies (31%) plan to extend their existing business with new core portfolio assets.



Key incentives for the development of refining companies



According to the survey, the most impact on the development of oil refining industry in 2014 will be that of such measures as the approval of the general oil industry roadmap until 2020 (28% of the respondents vs. 7% in 2012 and 15% in 2011) and changes to excise tax rates (32% of the respondents versus 27% a year before).

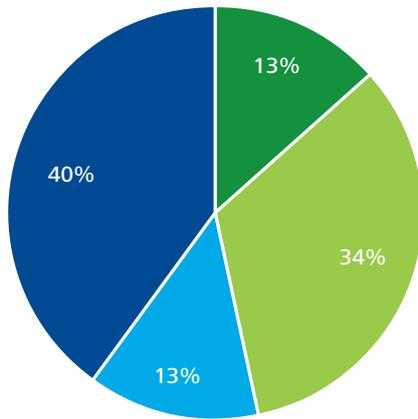
Less attention is being paid to changes made to the technological regulations on Euro-4 from September 2011, according to which companies must upgrade equipment and processes necessary to produce high-quality fuel and products with higher conversion ratios. This year only 8% of the respondents mentioned these changes, compared to 13% last year and 35% in 2011.

Company development plans in 2014 by activity

Field development

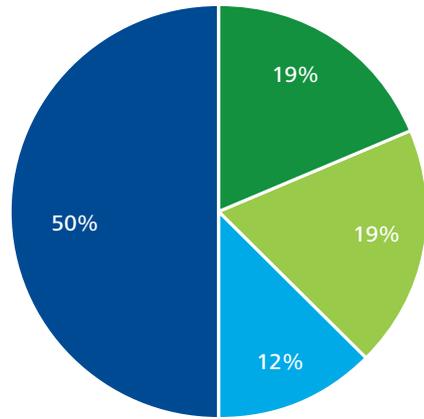
Seismic survey

- Increase
- Remain the same
- Decrease
- Don't know

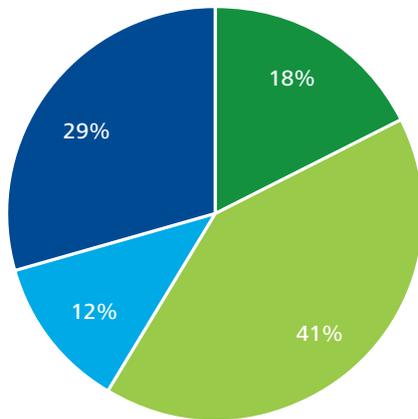


Upstream

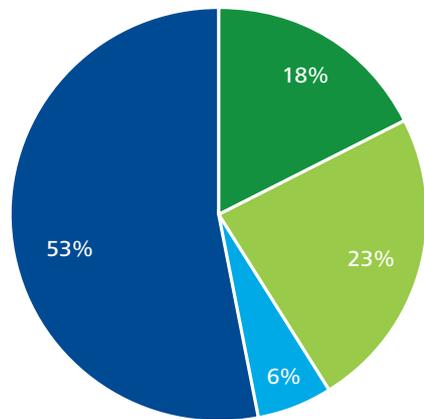
Drilling



Exploratory drilling



Improving efficiency in the use of fields



In the upcoming year, most (about 70%) companies plan to either increase or maintain the 2013 level of seismic exploration and exploratory drilling costs: 40% of respondents plan to increase seismic exploration costs, and 30% drilling costs.

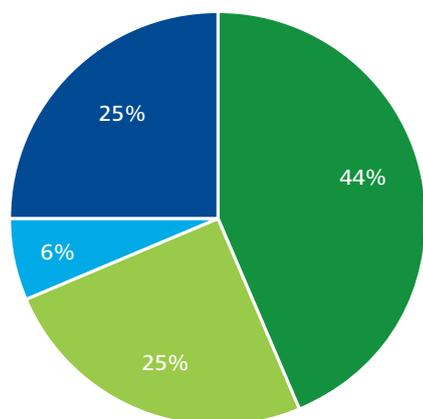
About 12% of the survey participants noted that in 2014 their companies may reduce their seismic exploration and exploratory drilling expenditure.

In 2014, more than half of the interviewed companies plan to increase expenditure on both drilling (50% of the respondents) and initiatives aimed at improving field development efficiency (53% of the interviewees).

About 20% of the respondents, in turn, plan to keep expenditure on these activities at the same level as last year.

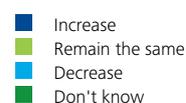
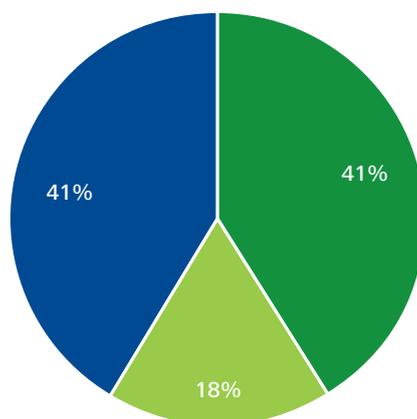
Midstream

Total processing capacity

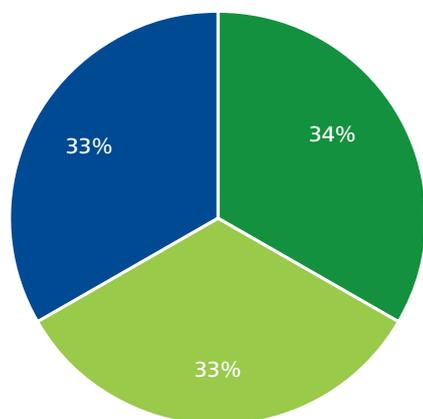


Downstream

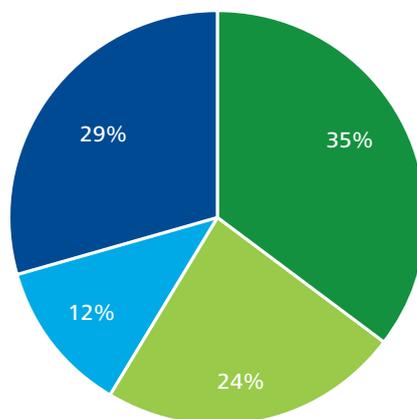
Number of fuel stations



Processing efficiency



Product and service offerings



Almost half (44%) of companies have yet to finalise their positions on the need to upgrade oil refining facilities in 2014. 25% of companies plan to increase this expenditure (2012: 28%), and 25% plan to keep it at this year's level (2012: 36%).

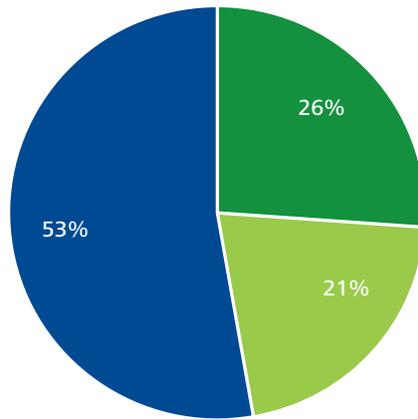
In 2014, 41% (compared to 36% a year before) of the companies intend to increase the expenditure on the construction of new filling stations, and only 29% (as compared to 57% in 2012) plan to extend the range of goods and services offered.

As for the conversion ratio, the interviewees were almost equally split about their 2014 plans: 34% of companies plan to ramp up this expenditure, 33% will keep it at current year's level, and the remaining 33% have yet to determine their positions on the issue.

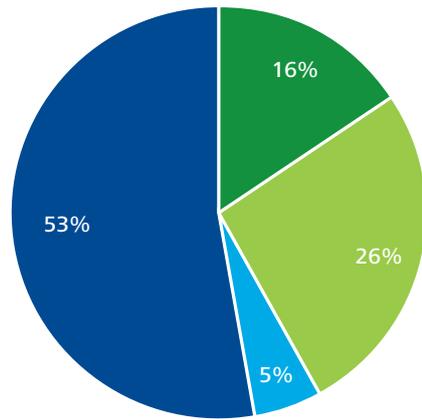
In 2013, your company's spending in the following areas:

R&D in oil & gas upstream

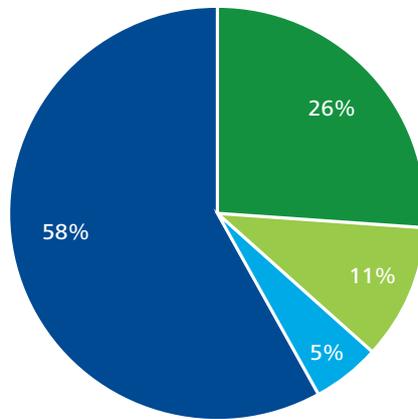
- Increased
- Remained the same
- Decreased
- Don't know



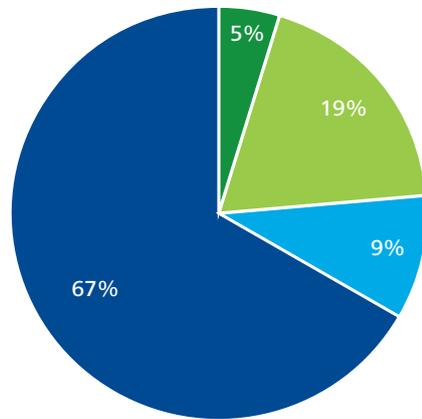
Capital projects



R&D in oil & gas downstream



Operational activities



The increase in the role of new territories and offshore areas of regional seas and the continental shelf in hydrocarbon development and the need to make downstream operations more technologically sophisticated are both incentives for companies in the industry to invest significantly into research and development related to oil and gas exploration and production, and into a general overhaul of oil and gas processes and processing equipment.

Over half (53%, compared with 54% last year) of interviewed companies plan to increase R&D expenditure in the upstream segment. Another quarter of the participants expect to keep their investments in new developments in the segment at the current year's level.

A full 58% of the respondents plan to increase innovation expenditure in the downstream segment, whereas 11% of the interviewees believe that there is no need to change the level of this expenditure and plan to keep it at the 2013 level. It is worth noting that 5% of the experts are considering reducing costs related to implementing innovation in the downstream segment.

More than half (53%) of companies increased capital construction volumes in 2013 (compared with 79% last year), whereas 5% reduced them (this figure has not changed from the previous year).

Among the respondents, 67% noted an increase of operating costs this year (down from 71% last year), 9% noting a decrease (no such responses were given last year).

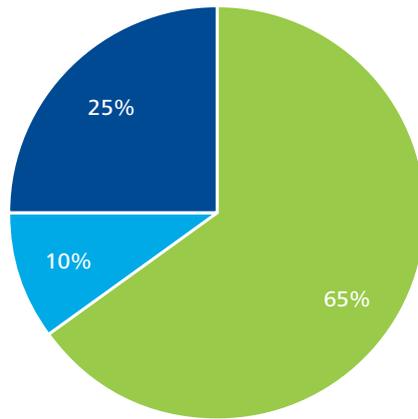
High oil prices (more than USD 100 per barrel) provide both an incentive and an opportunity for companies to invest in capital construction and current operations, new developments and innovation.

Investment in social programmes has not changed significantly from the previous year. 20% of companies have increased this expenditure, with 65% of the respondents keeping it at the same level and only 10% reducing it.

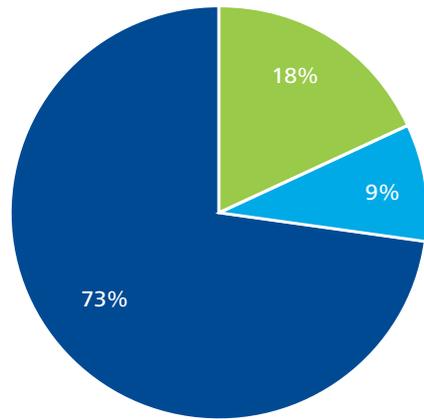
In 2013, your company's spending in the following areas (cont):

Social programs

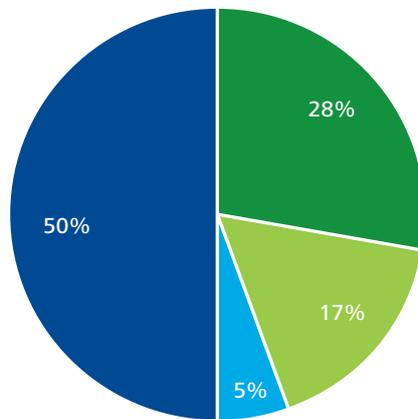
- Increased
- Remained the same
- Decreased
- Don't know



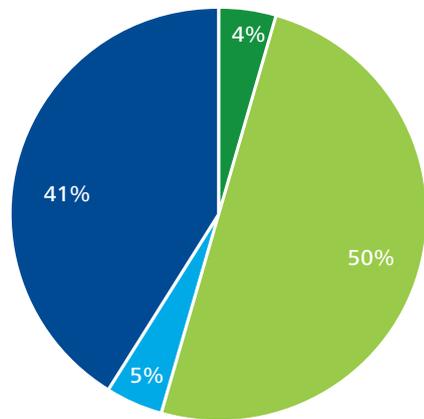
Personnel training activities



Environmental safety, including utilization of gas from oil wells



Occupational health and safety





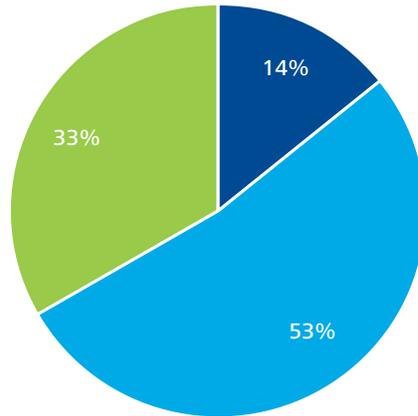
In 2013, exactly half of the companies ramped up their environmental expenditure, and 17% kept it at the level of the previous year. This is partly due to the need to recover 95% of associated petroleum gas, which came into effect on 1 January 2012.

In the short term, the number of companies that invest heavily in the development of their environmental aspects is expected to grow further.

2013 saw significant growth of personnel costs, including training costs – this trend was noted by 7% of the interviewees (36% a year before). This is likely to be due to the increased proportion of companies that implement new technology and upgrade their production facilities.

Only 9% of companies have reduced this expenditure. In 2013, health and safety costs were increased at more than 40% of companies (which is a continuation of the trend that started in 2011), although 50% of the interviewees did not change the level of health and safety investment.

Investment in research and development into alternative energy sources



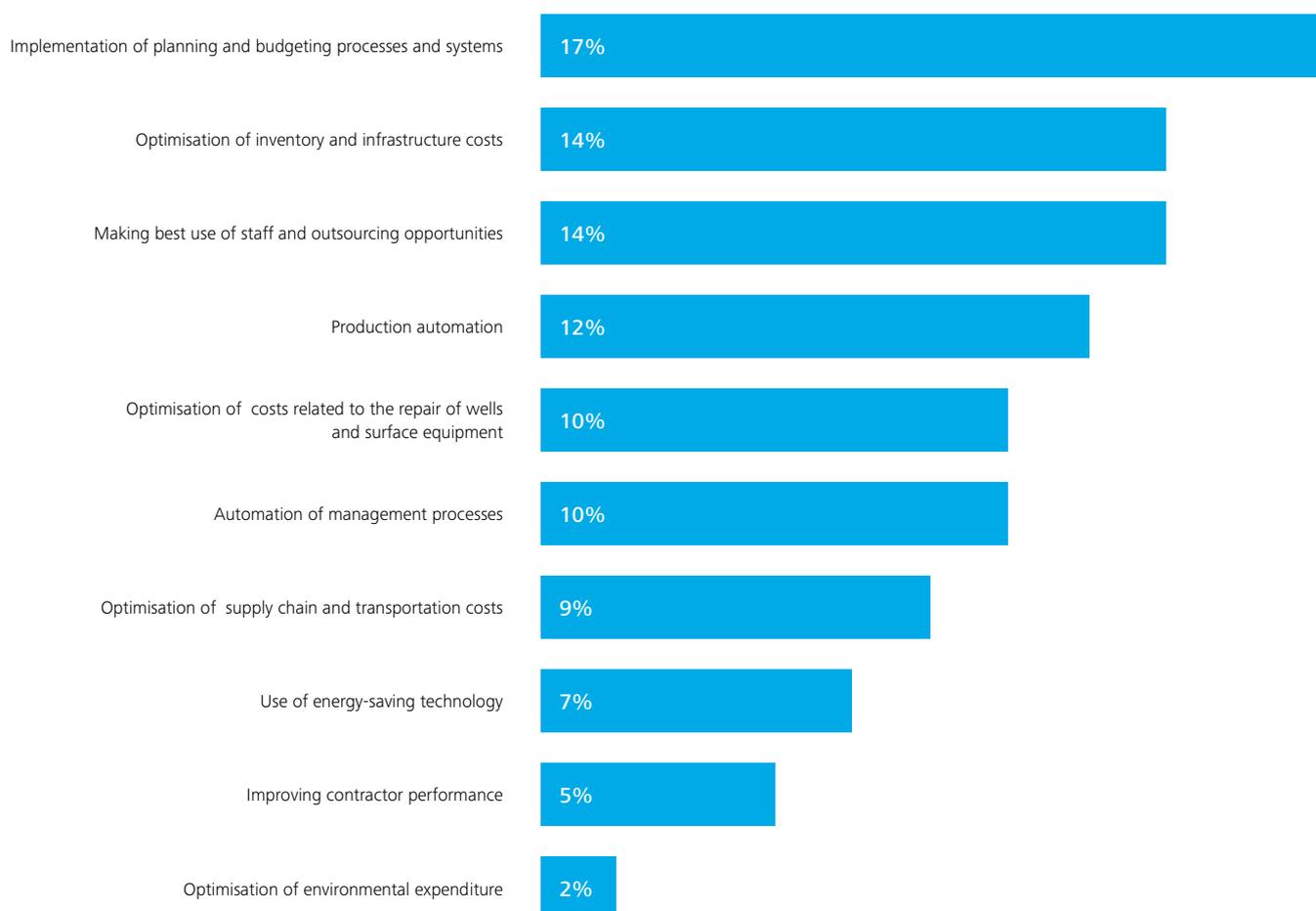
- Companies are investing and plan to increase investment in 2014
- Companies do not currently invest and have no plans to do so in 2014
- Companies do not currently invest, but have plans to do so in 2014

Now about half of the respondents have expressed an interest in examining and developing alternative energy sources

The depletion of natural reserves, the increased complication of the reserve extraction process and new environmental requirements all drive energy companies to invest in research and development of alternative energy sources.

As a result, the interest of Russian companies in alternative energy sources is growing. Whereas only 23% of respondents were ready to invest in non-conventional energy sources (15% were already making such an investment, 8% were ready to begin research in this direction), now about half of the respondents have expressed an interest in examining and developing alternative energy sources (14% of companies are now making such investments and 33% are planning to start investing in this area in the near future).

Management and control of operating costs in 2014

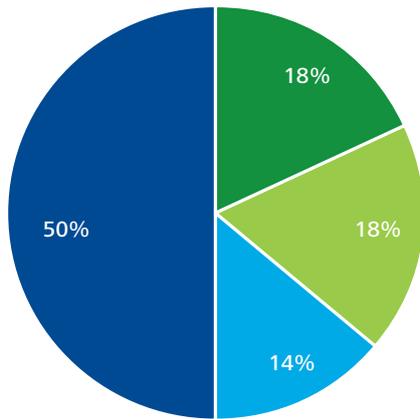


The respondents named the planning and budgeting processes and systems as the most important tool for maintaining control over operating expenses (17% of the respondents). Procurement cost optimisation initiatives are also important to the respondents; however, this year they have become less popular than they were last year (14%, down from 26% a year before). Personnel optimisation and outsourcing have become more important in terms of reducing operating costs as compared to last year (14% vs. 10%).

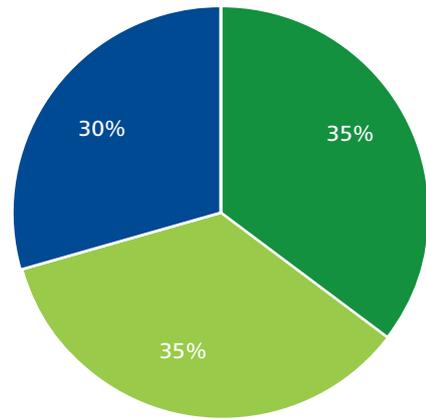
Capital investment plans in 2014

Purchasing inventory

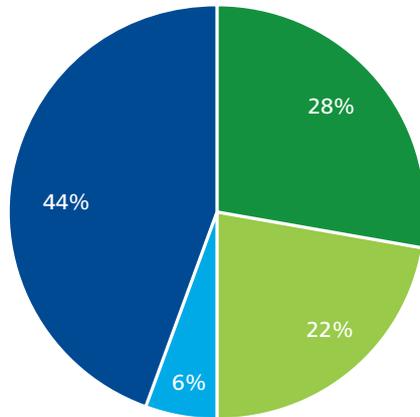
- Increase
- Remain the same
- Decrease
- Don't know



Upstream



Field development



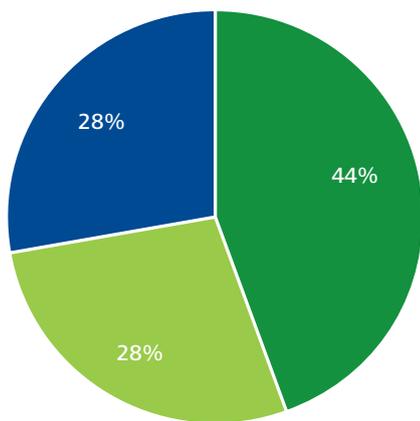
Half of the respondents confirmed their intention to increase their investment in the acquisition of new assets. This figure grew by 19% from last year.

It is likely that 18% of companies will bide their time and keep their asset portfolios unchanged.

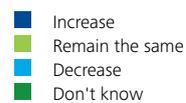
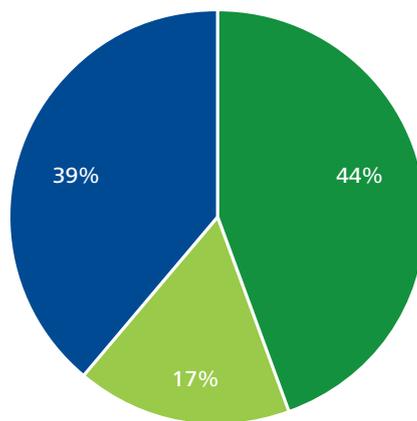
14% of the respondents intend to reduce capital investment into this area.

The proportion of companies that are planning to increase investment in field development has dropped compared to last year, standing at 44%, compared to 64% in 2012.

Midstream



Downstream



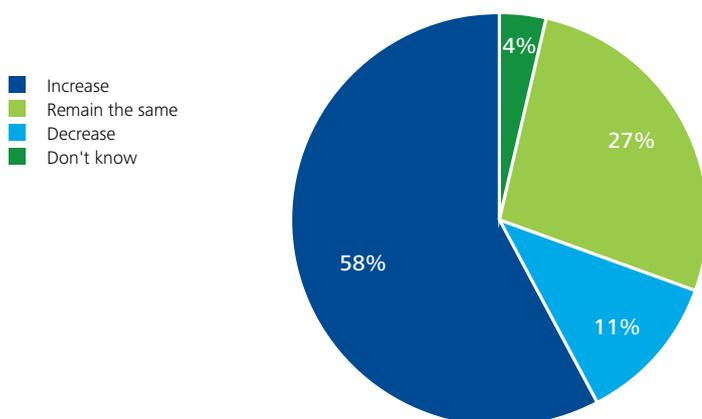
22% of the respondents plan to keep their investment into field development at the current year's level (this answer was given by 14% of the respondents last year).

Only 6% of the interviewees indicated that they were not going to increase field development expenditure. The 2014 plans for production costs are as follows:

- 30% of companies are interested in stepping up production costs (last year this answer was chosen by 78% of the respondents)
- 35% of the companies are not planning any changes (7% last year).

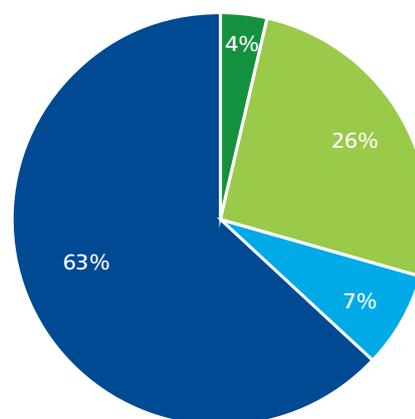
State involvement in the Russian oil and gas industry in the near future

Over the next 5 years, participation by state companies in the industry will:



Last year the proportion of respondents anticipating an increase in the participation of state-owned companies in the industry was at a record 80%. This year the figure went down by more than 20% (to 58%). This drop may be due to the fact that, in accordance with technical regulations, oil companies must finish upgrading their facilities by 2016 and switch to the production of modern types of fuel. Oil refineries owned by large state-owned companies are not currently fully prepared to produce higher-quality fuel in the necessary volume.

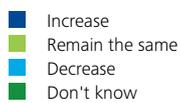
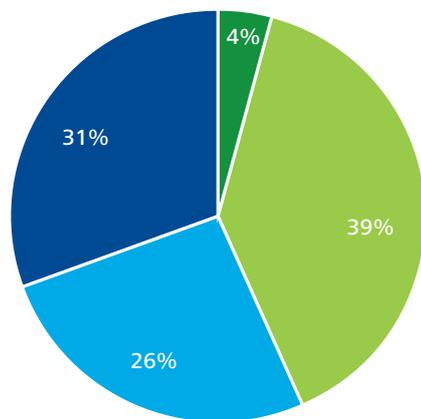
Over the next 5 years, state regulation of the oil and gas industry will:



There has been a significant reduction in the number of respondents who anticipate an increase in the level of government intervention in the Russian oil and gas industry (63% versus 73% last year). Thus, the implementation of a number of large investment projects in the sector is being delayed in anticipation of government support measures, expected to take the form of preferential tax treatment. Over a quarter (26%) of the respondents believe that the level of state regulation will remain unchanged (2012: 20%) and 7% of respondents anticipate that it will reduce (similar to last year's figure).

Participation of foreign companies in oil and gas projects

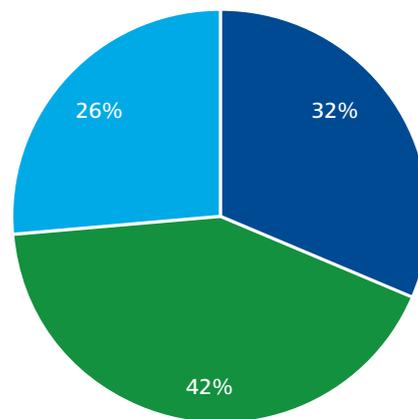
Foreign capital in oil and gas projects in 2014



Almost a third (31%) of the participants feel that the already solid share of foreign participation in oil and gas projects will only continue to grow next year, likely due to the need to conduct work in complex geographical conditions and, as a result, use sophisticated technology that is not readily available to domestic companies.

39% of respondents expect the share of foreign companies in oil and gas projects to remain the same as this year.

The need for PSAs when developing new deposits



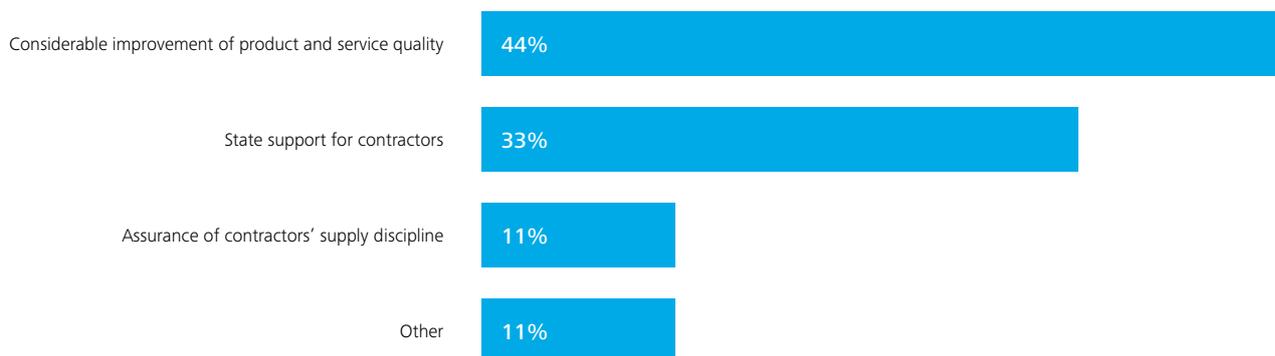
Whereas last year the respondents were almost unanimous in favouring the return of the PSA regime (85% of respondents), opinion is now divided equally:

- 32% of the respondents voiced the need to use PSAs when developing new deposits
- 26% were against this measure.

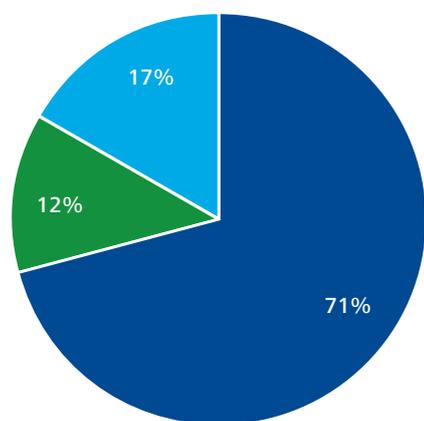
It is worth noting that almost half (42%) of the respondents were unable to give a definite answer to the question (15% a year before).

Participation of Russian contractors in oil and gas projects

Key steps to increase the participation of Russian contractors in oil and gas projects



Need for a unified public database of oil and gas contractors



■ Yes
■ No
■ Don't know

The respondents believe that Russian suppliers could gain a much bigger share in oil and gas projects if there was a significant improvement in the quality of goods and services (44% of the respondents, the same as last year) and state support (33% in 2013, compared to 17% in 2012).

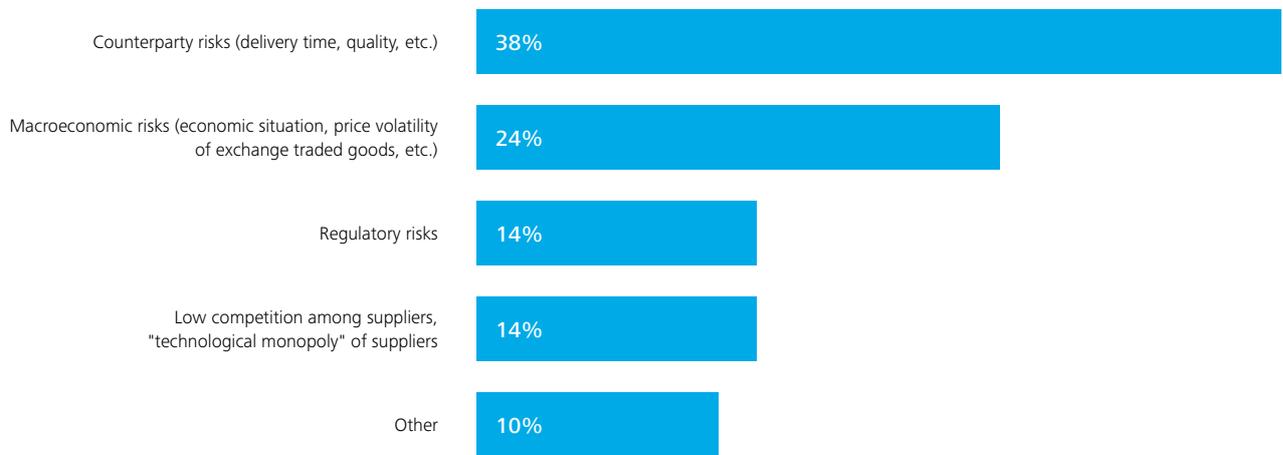
Apart from better quality, the experts (11% of the respondents) believe that strict compliance by Russian suppliers with their contractual obligations with respect to supply timing and volumes could boost confidence in the industry.

Like last year, the majority of the respondents (2013: 71%; 2012: 69%) agreed that a common, publicly-accessible supplier database is needed.

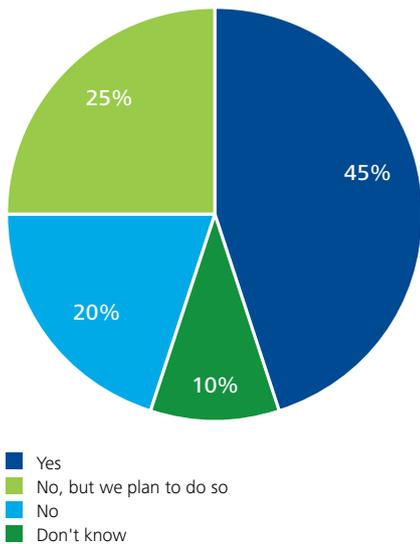
However, 17% of the respondents (2012: 8%) do not believe it is necessary. 12% of the industry respondents did not comment on it.

Procurement in oil and gas companies

Key procurement risks facing companies



Does your company categorise materials and services procured?



More than a third of the respondents (38%) have specified contractual failures by suppliers, including shipment delays, inadequate quality, etc., as a key supply chain risk. In addition, 24% of the respondents are concerned about the global macroeconomic environment.

The experts have also named some other supply chain risks for oil and gas companies, including: low competition among suppliers, technologically monopolistic suppliers (14%) and a resulting decrease in supplier competition, as well as a lack of regulation from the government (14%).

70% of the respondents believe that supply chain management is necessary, including processes based on procurement strategies and categories. Moreover, these processes are already being implemented at 45% of the respondent companies. 25% of those companies surveyed have also responded that their companies are planning to implement similar procedures in the near future.

10% of the respondents are not sure whether such procedures are needed, and 20% do not believe they are necessary.

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