



2011 Russian
Oil & Gas
Outlook Survey

Introduction



As a new year begins, we may conclude that 2010 was quite a successful year for the Russian oil and gas industry. The recovery of raw material markets provides a confidence boost to industry participants and allows them to start planning long-term activities once again.

In any industry, an exchange of views, plans and forecasts is necessary to secure smooth development. The greater the transparency of information that companies provide, the higher the confidence of investors and business partners will be. Therefore, we have prepared this survey with a wide range of readers in mind, and we will attempt to present a picture of how oil and gas company executives regard their business development opportunities in today's increasingly favorable market conditions.

Industry indicators for 2010 (oil prices and production) have demonstrated positive dynamics. Due to the gradual recovery from the global financial crisis throughout 2010, oil prices stabilized at a level of USD 75-90 per barrel. The oil production growth rate in Russia is returning to pre-crisis levels of between 2 and 2.4%, while oil and gas companies have been reporting increased profits and revenue. By the end of the year, the capacity of Russian oil refineries was set to return to 2008 levels.

One of the most significant global events for the oil and gas industry was the accident on the BP-leased Deepwater Horizon rig. Direct damage to the company as a result of the disaster amounted to USD 8 billion, while it will take years, or even decades, to deal with the environmental consequences. This incident has forced all oil and gas companies to reconsider their security and labor protection policies.

Today, companies are planning to increase investments in areas that have suffered reductions in previous years, such as innovative solutions, research and capital projects. Respondents said that the aim behind these investments was to raise the profile of their business in terms of both quantity and quality, which will require the implementation of new technologies. Due to the difficulties associated with oil production and the implementation of new state regulations (requirements regarding the utilization of associated gas and Euro 4 technical regulations, among others), oil and gas companies will need additional sources of capital in the near future.

Respondents say that, to date, credit (a very unreliable source of funding just a year ago) is still the main source of financing. In order to raise funds internally, companies plan to enhance cost control measures and increase efficiency by implementing strategic initiatives.

In short then, the overriding conclusion from this survey is that oil and gas companies have significantly recovered from the crisis and are prepared for the rapid growth ahead. The readiness of companies to take on new debt and develop new projects strongly suggests that this year will be very important for the industry.

The details of our survey can be found below. We would like to thank everyone who took part and wish all oil and gas industry participants success in 2011!

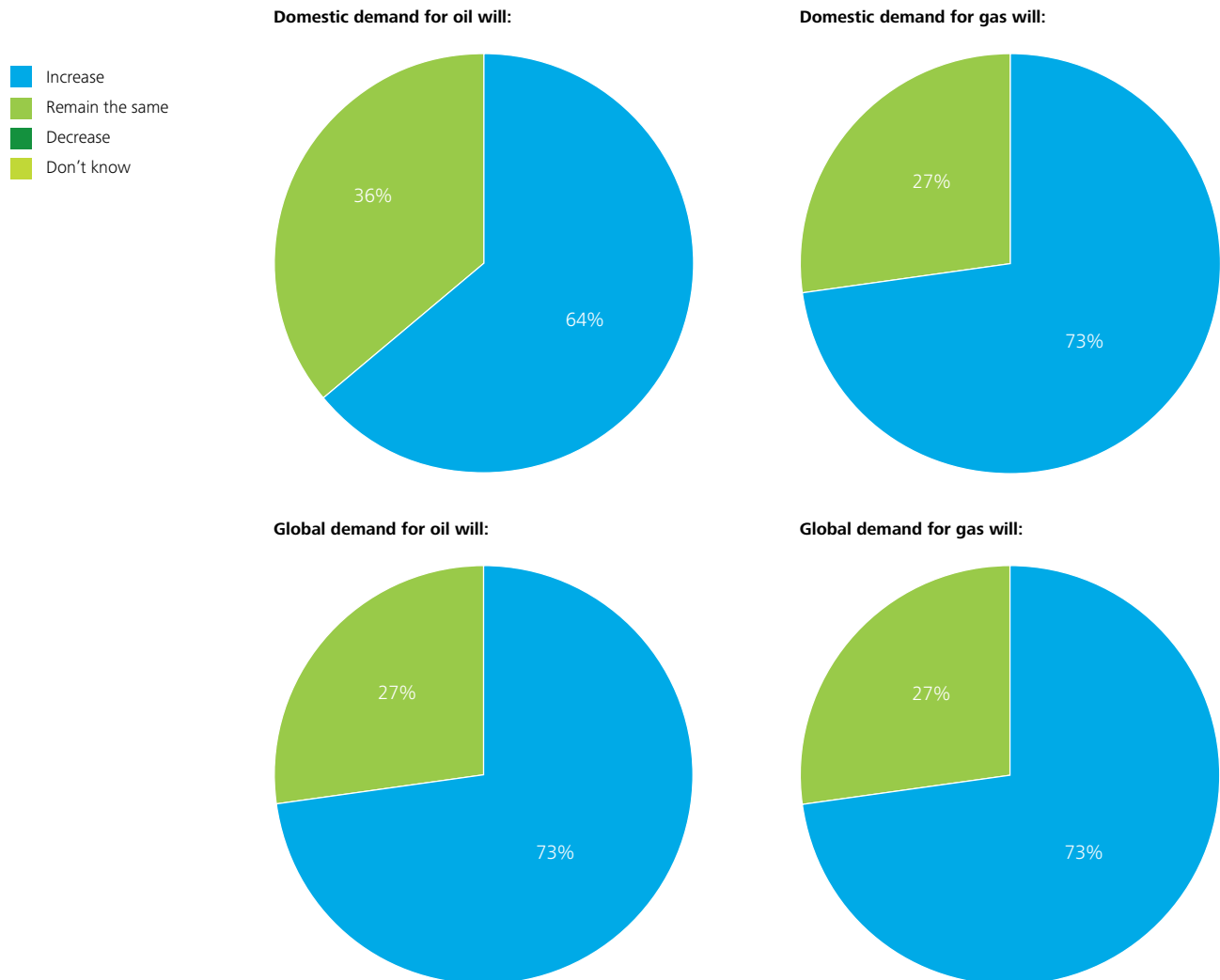
Elena Lazko

Partner
CIS Oil & Gas Leader

A handwritten signature in blue ink, appearing to read 'Lazko', written in a cursive style.

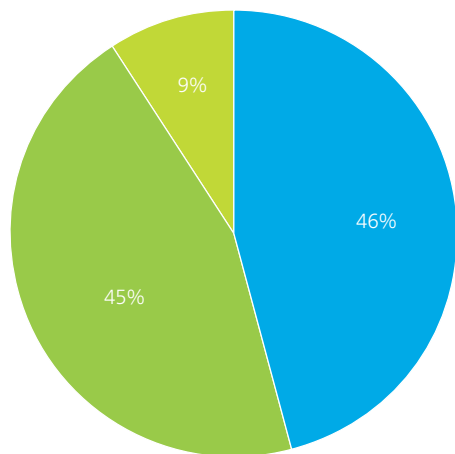
2011 Russian Oil & Gas Outlook Survey

How do you see the demand for domestic and global oil and gas changing over the next 5 years?



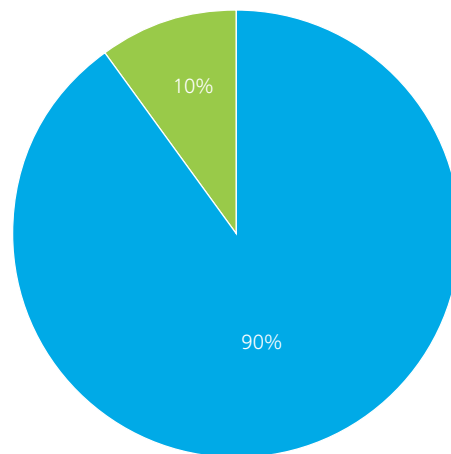
Respondents are quite optimistic in their outlook regarding the demand for oil and gas products. Compared to the end of the first post-crisis year, when about a third of respondents gave positive estimates for growth in oil and gas demand, this year the number of positive responses has doubled (64%). Global oil market forecasts are close to domestic views, in that companies do not expect any diminution in demand for oil in the near future. In fact, respondents were even more optimistic in their outlook for global gas demand, with half of the 73% of respondents predicting significant growth in gas demand. Despite the slowdown in growth in the USA and Japan, worldwide demand for gas is expected to grow, driven by the growing economies of a number of Asian countries.

Compared with current prices, oil prices in 2011 will:

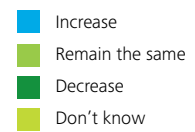


Last year, oil prices remained at a comfortable level for oil production companies of USD 75-90 per barrel. Respondents anticipate stabilization or growth of oil prices, due to moderate forecasts for the recovery of the economies of various countries and global demand for energy resources. Respondents' views were split almost evenly (45%) between these two scenarios. However, as a sharp growth of prices could threaten post-crisis recovery, a significant increase in oil prices is seen as unlikely.

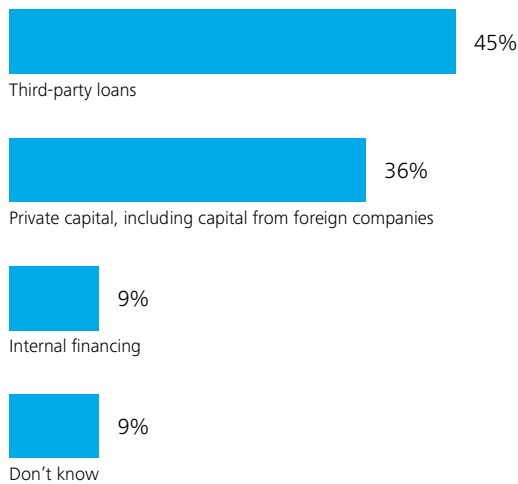
Over the next 5 years, the demand for capital in the Russian oil and gas industry will:



Over a period of several years, we can see how companies in the industry have remained resolute when faced with a significant growth in the demand for capital. While respondents last year expected a decrease in demand for capital, this year the situation has changed. The trend toward an increase in capital investments can be explained by the expected growth in demand for energy resources, implementation of Euro 4 environmental standards, and the complications associated with the development of new (including offshore) and existing deposits. Plans for a reduction in state funding for early-stage field developments are also noteworthy, as this may lead to an increase in companies' costs associated with the development of new oilfields.



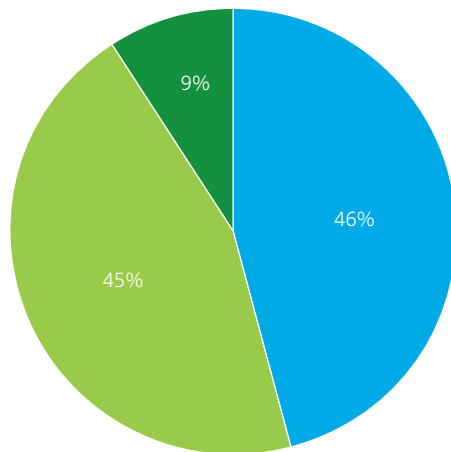
Over the next 5 years, the primary source of capital for the Russian oil and gas industry will be:



As a result of the softening of monetary policies by central banks and growing trust between financial institutions and companies in the real sectors, 45% of respondents said that they expect to see an increase in loan financing, compared to only 6% the previous year. Meanwhile, 36% of respondents now consider private capital to be the main source of financing, increasing from the previously stable level of 20%. In a departure from previous years' results, no respondents selected IPOs as the primary source of financing. In light of this, it comes as a worrying surprise that companies are now considering increasing their debt burdens. Should prices and demand for oil remain flat, companies would increasingly need to consider imposing stricter controls over their costs, in order to cope with growing financial obligations.

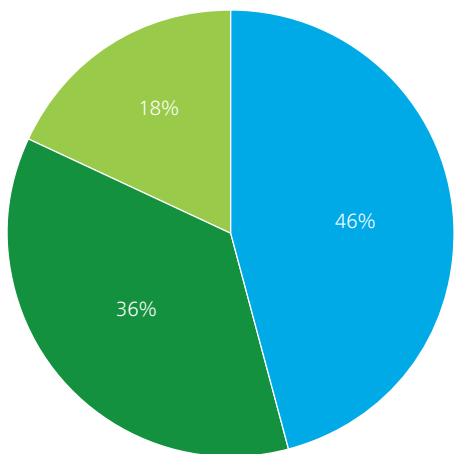
Over the next 5 years, the inflow of capital into the Russian oil and gas industry will:

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

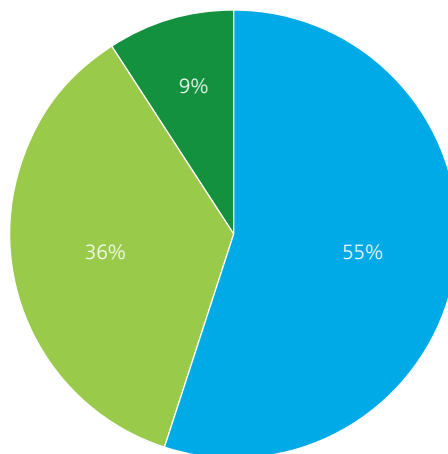


In many industries, capital inflows are primarily driven by profitability and risk levels. However, in the oil industry, returns on investments largely depend on energy prices. With oil prices almost doubling by the end of 2007, companies were at their most optimistic, with 61% of respondents expecting an increase in investments. This optimistic outlook was also seen a year ago (59%), following the recovery of quotations from local minimums. Optimism within the industry is now at its highest level since 2008, with 46% of respondents now expecting a rise in capital inflows, as there is no low-base effect and the price growth limit has been reached. In this climate, it is no surprise that respondents do not expect to raise funds through IPOs. In addition, an expected increase in the tax burden for the oil and gas industry, as a result of a planned increase in basic MET rates, along with certain other measures, could have an impact on the industry's investment appeal.

Over the next 5 years, the participation of state-owned companies in the industry will:



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

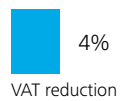
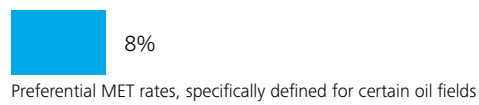
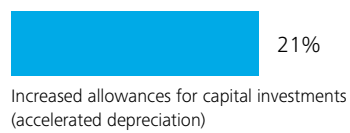
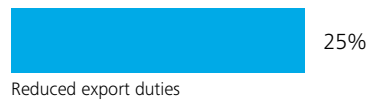
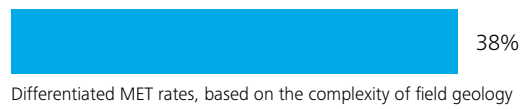


- Increase
- Remain the same
- Decrease
- Don't know

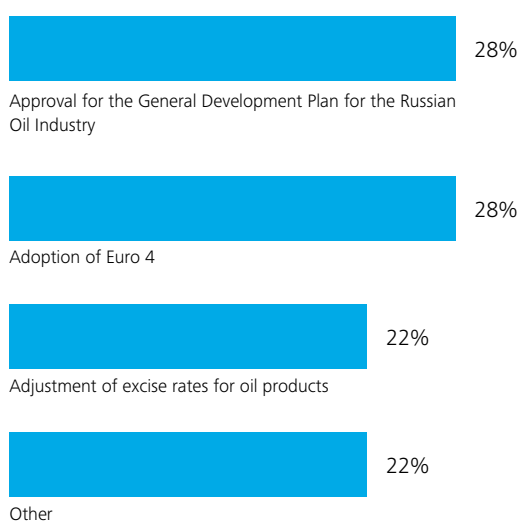
Responses generally remained the same as in previous years, with half of respondents believing that the state will increase its presence in the industry. The number of respondents holding this view has remained in the region of 55-60% for several years now, reflecting concerns within the industry over future regulation based on political maneuvering, as the government seeks to close a budget gap with the help of oil and gas industry revenues over the course of the next several years. However, at the same time, a significant proportion of respondents (36%) did not expect any notable shifts in state regulation.

From the tax changes and incentives below, please select those that are the most beneficial to the industry:

Differentiated MET rates 38%, reduced export duties and increased allowance for capital investments are among the most preferred incentives named by the industry.

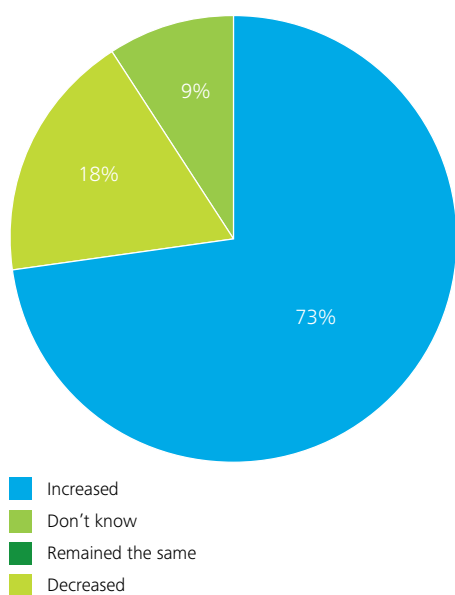


Which of the following measures do you think would be the most beneficial to the oil processing industry?



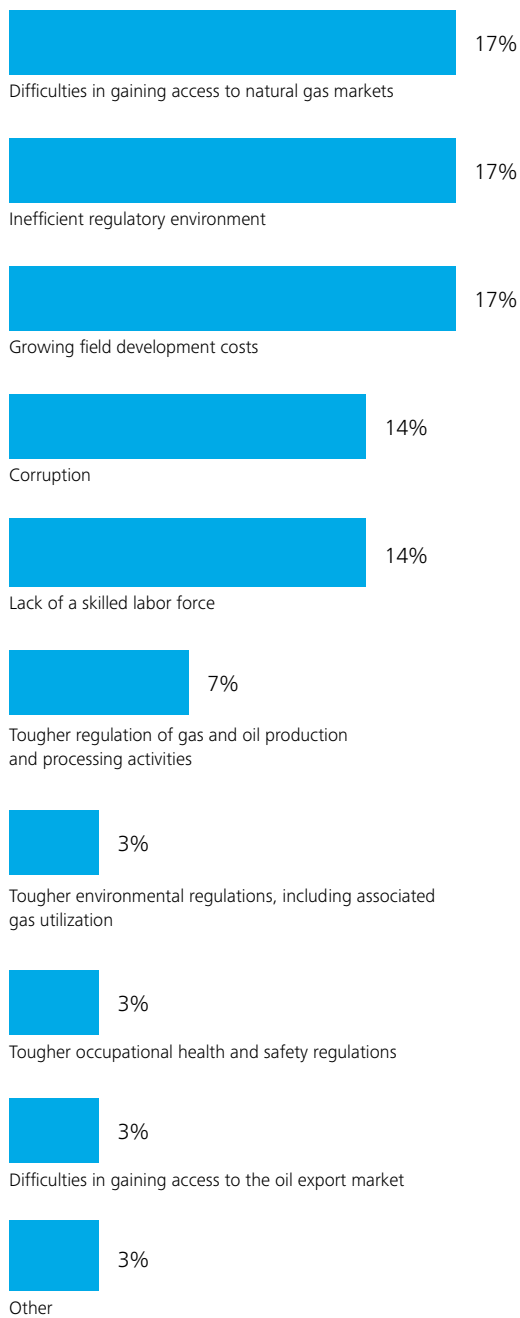
There was no clear favorite among the above measures for respondents. The adoption of Euro 4 (28%) and the approval of the General Plan for the Development of the Oil Industry (also 28%) were viewed as being the most beneficial to the industry. At the same time, respondents did not view the adjustment of excise rates for oil products as a particularly beneficial measure. In general, an understanding of which measures are the most effective and which are not still evades the industry, and there is still a lack of consensus regarding any particular measure. Meanwhile, it appears that discussions over the issue of stimulating the oil refining sector will continue.

In 2010, your production assets have:



In addition to positive trends in oil prices, the increased activity of companies in terms of expanding their asset portfolios may be yet another sign of economic recovery. In 2009, most companies were concerned primarily with retaining their assets. However, this year, 73% of the companies surveyed reported purchases of new assets, including 18% that significantly increased their asset levels.

From the issues below, please select the most critical that the oil and gas industry currently faces:

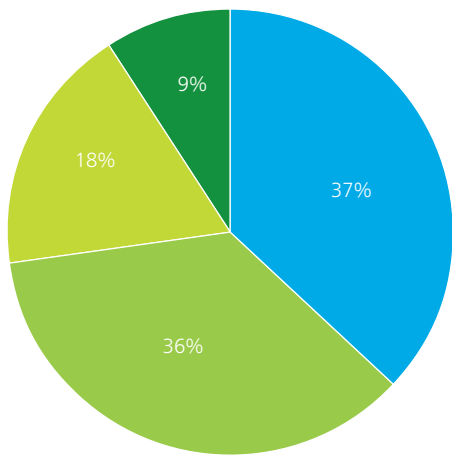


According to respondents, an inefficient regulatory environment, the lack of a skilled labor force, corruption, growing development costs and difficulties in gaining access to gas markets are the most important issues facing the industry, with the last of these a growing concern. Liberalization of the gas market and work to ensure parity between domestic tariffs and export prices are both of critical importance to independent gas producers, as these mechanisms will enable companies to plan long-term projects.

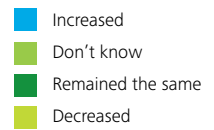
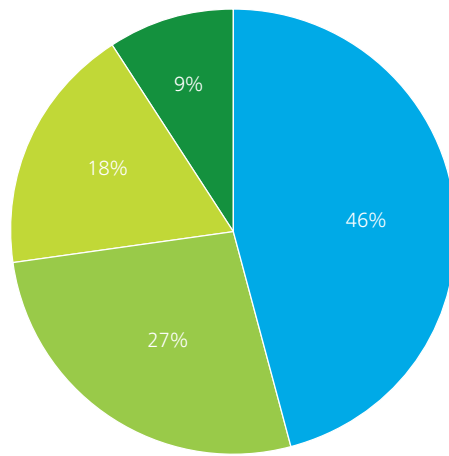
Your headcount in 2010 has:

Headquarters

The management

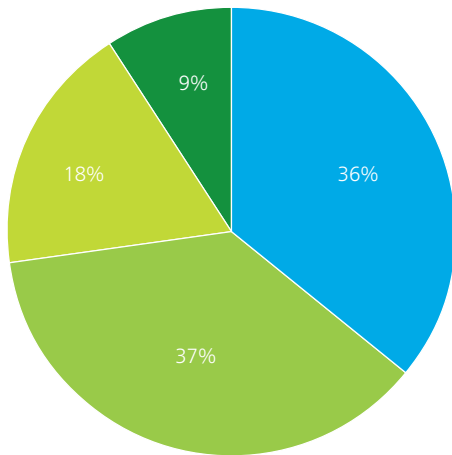


Specialists, administrative personnel

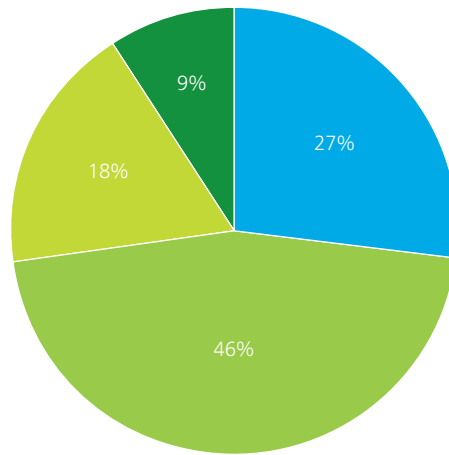


Production units

Managers, specialists, administrative personnel



Workers



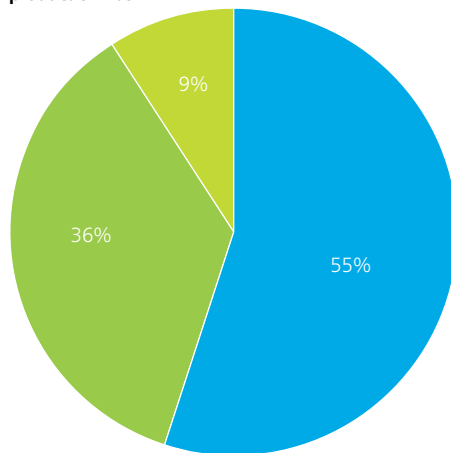
During 2010, headcounts at the surveyed companies were more dynamic than in 2009, when around 50% of the surveyed companies neither increased nor reduced their headcount (about a third of companies saw a reduction at this time). Management figures either remained unchanged (headquarters — 36%; production units — 37%) or increased (headquarters — 37%; production units — 36%). Production units demonstrated the most stable headcount numbers, as 46% of respondents reported no changes in this area, and 18% said that their headcount saw either an increase or a reduction. Headquarters were reported to have been the most active in hiring specialists and administrative personnel, with 46% of respondents reporting increases in these areas.

With respect to the areas specified below, how did your company's spending structure change in 2010?

Companies' growing expenditure is connected with the worldwide economic recovery following the crisis, along with the increase in oil prices to 75 USD or more per barrel. In 2010, most companies increased their investments in areas such as capital construction and R&D. Respondents also noted increased operating expenditure, whereas spending in areas such as personnel training, HSE and associated gas utilization have changed less. Levels of social contributions also generally remained the same. At the same time, it should be noted that social contributions also remained stable in 2009, as oil and gas companies maintained their spending on social programs, personnel training and safety, even amid the crisis.

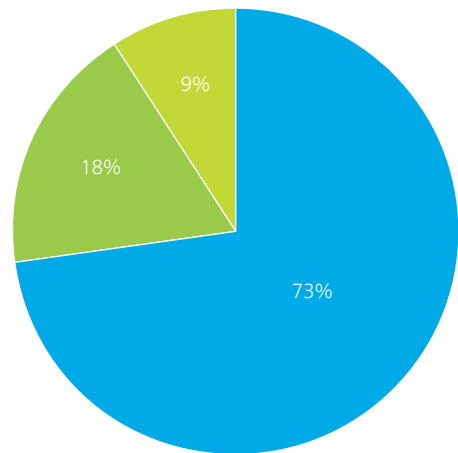
- Increased
- Don't know
- Remained the same
- Decreased

The level of innovation activities in the oil and gas production has:



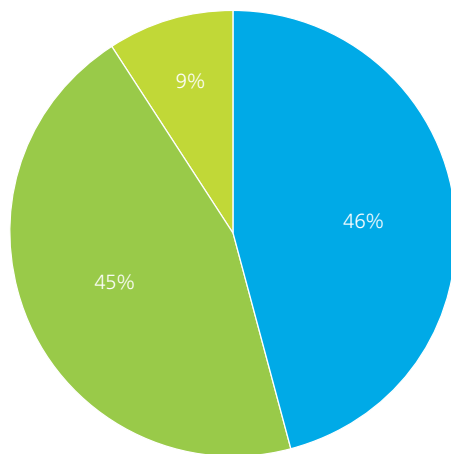
55% of respondents have increased their R&D expenditures, including 9% of respondents who significantly increased their R&D expenditure. At the same time, 36% of respondents had similar levels of R&D expenditure to the previous year.

The level of operating activities has:



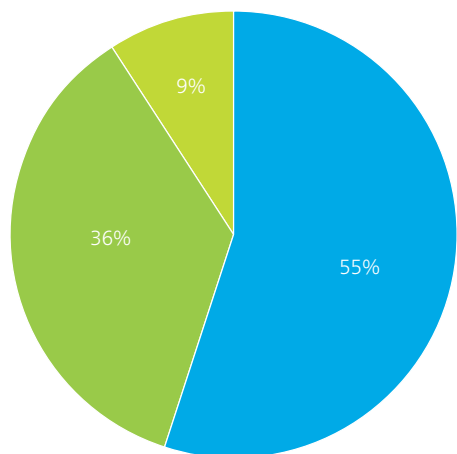
73% of respondents reported increased operating expenditure.

The level of social program investments has:



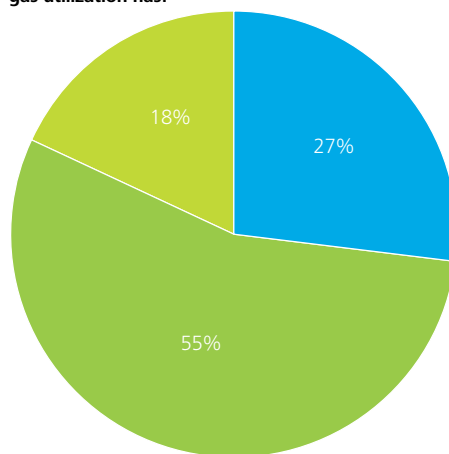
46% of respondents increased their level of social spending, while a further 45% spent the same amount as last year.

The level of capital construction has:

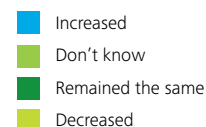


55% of respondents reported an increase in the level of capital construction, including 18% reporting significant increases. 36% reported no change in spending in this area.

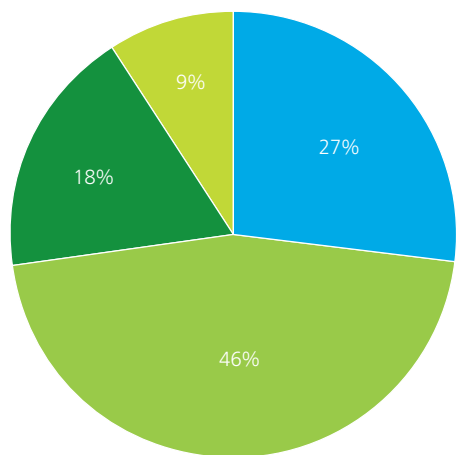
The level of environmental expenditure, including associated gas utilization has:



More than 50% of respondents have kept their expenditure on environmental measures at the same level, while 27% reported an increase.

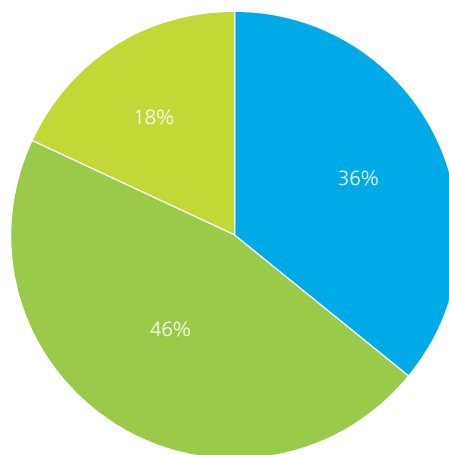


The level of personnel training activities has:



While only 18% of the companies surveyed reported reduced expenditure on personnel training, 27% increased their spending in this area (including 9% that significantly increased spending) and 46% maintained spending at the same level as last year.

The level of expenditure on occupational health and safety has:



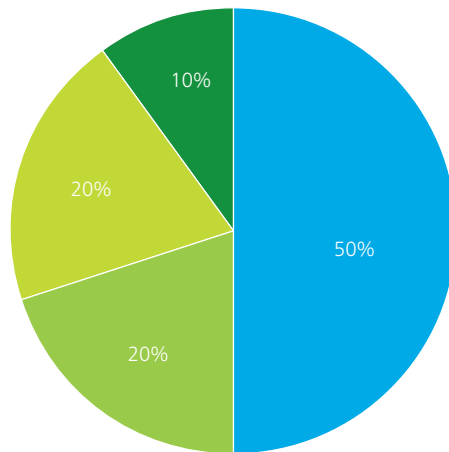
36% of respondents increased their spending on occupational health and safety, while 46% reported no change.

Compared with 2010, which of the following operational areas does your company plan to expand or cut back on in 2011?

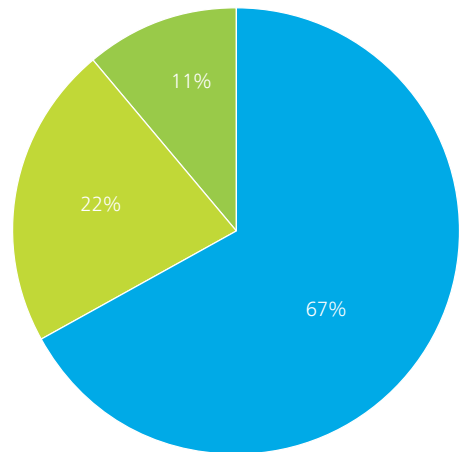
Respondents stated that they were planning to improve performance, in terms of both quantity and quality indicators, across the value chain. While this trend continues from the previous year, it also serves as a warning, in that 30% of respondents did not have clear development plans for their processing activities, while 40% had no such plans for expanding their sales activities.

Upstream — drilling: The level of expenditure on drilling operations in your company will:

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

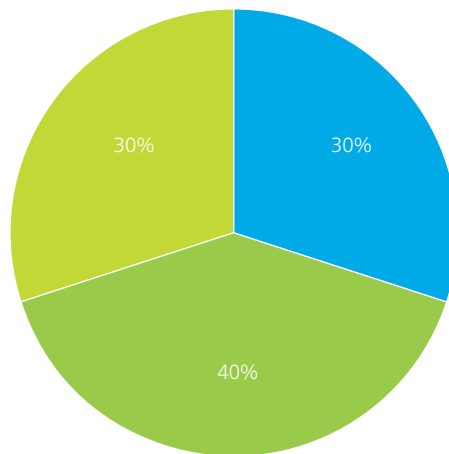


Upstream — efficient field development: The level of expenditure on efficient field development in your company will:

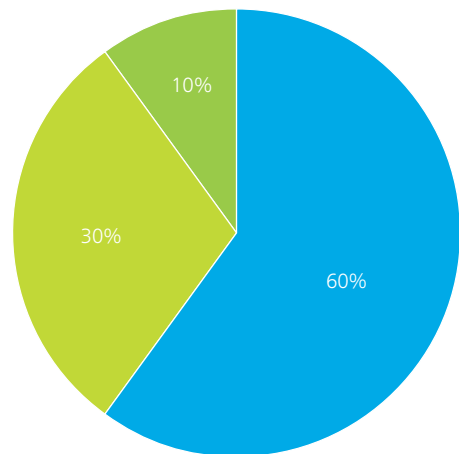


67% of respondents plan to improve the efficiency of their field development activities in 2011. Only 10% of the surveyed companies reported they had plans to reduce production.

Processing — total processing capacity: The level of expenditure on processing capacity in your company will:

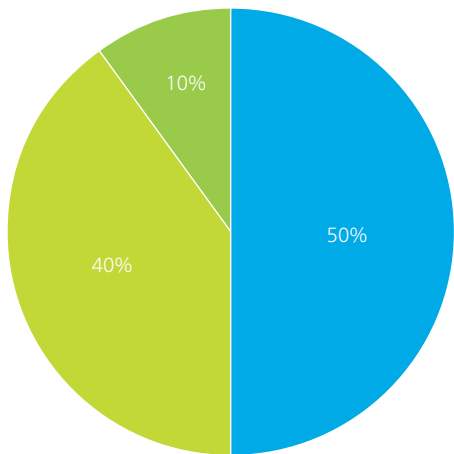


Processing — processing efficiency: The level of expenditure on improving processing efficiency in your company will:

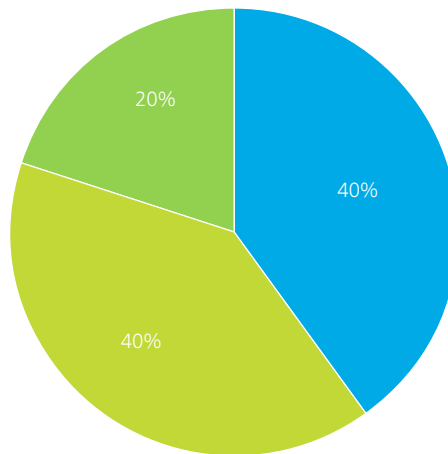


Only 30% of respondents stated that they would be expanding their processing capacity. Meanwhile, 60% replied that they would step up their investments in processing efficiency.

**Downstream — number of filling stations:
Expenditure in this area will:**



**Downstream — products and service offerings:
Your company's expenditure on products
and service offerings will:**



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

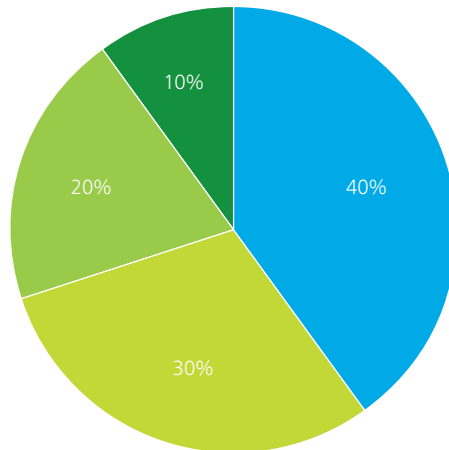
While 50% of the respondents plan to increase the number of filling stations they operate, only 40% have plans to improve service quality. According to the findings, companies will be more focused on improving the efficiency of oil production and processing in 2011.

Compared with 2010, in which of the operational areas specified below does your company plan to increase or cut-back on capital investments in 2011?

Many respondents reported increased capital investments in most of the areas. However, the level of uncertainty among respondents increased to 30-40% this year, up from 6-12% the previous year.

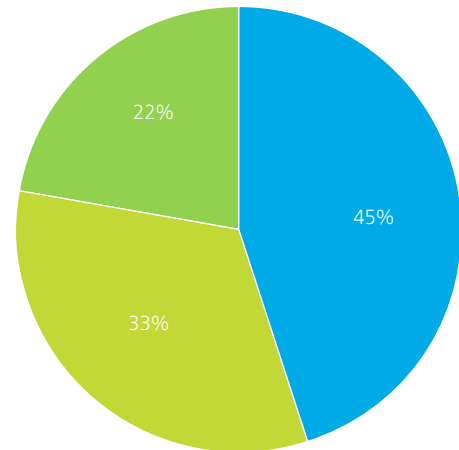
The level of purchases of reserves by your company will:

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



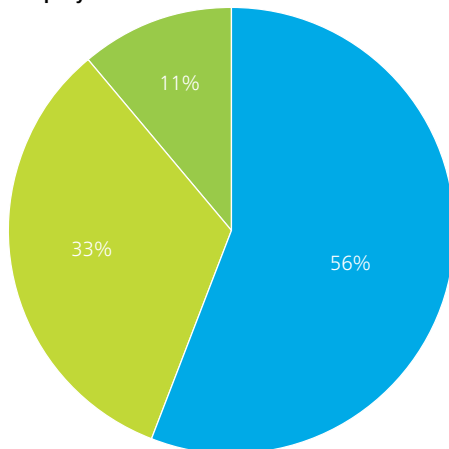
This year, only 40% of respondents said that they would consider purchasing assets, against 64% the previous year. 10% of respondents said that they would cut their investments in purchases of reserves.

The level of field development activity in your company will:



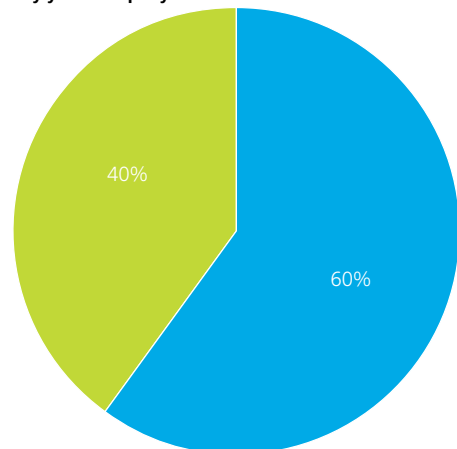
45% of respondents said that they plan to invest more in field development activities next year, against 65% the previous year.

The level of expenditure on extracting activities by your company will:



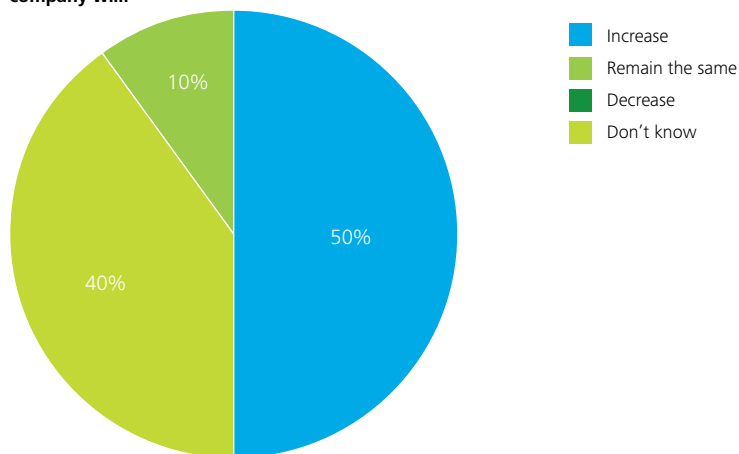
56% of respondents are considering increasing their investment in extracting activities, against 50% the previous year.

The level of expenditure on expanding sales activities by your company will:



60% of respondents plan to spend more on expanding sales activities in 2011, than in 2010. A significant proportion of respondents (40%) remained uncertain about their plans for the coming year.

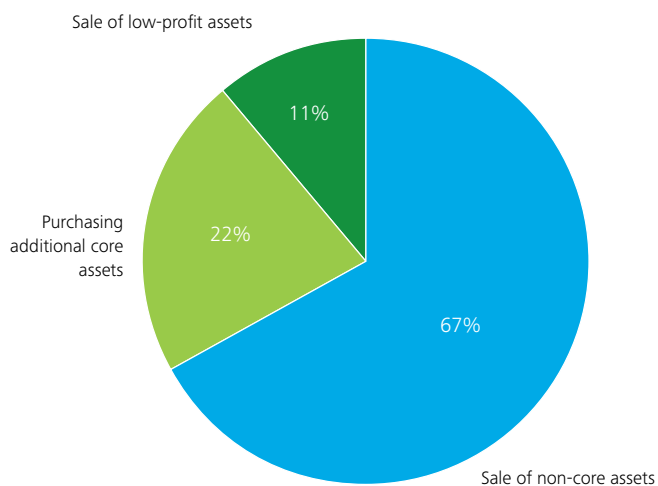
The level of expenditure on processing activities by your company will:



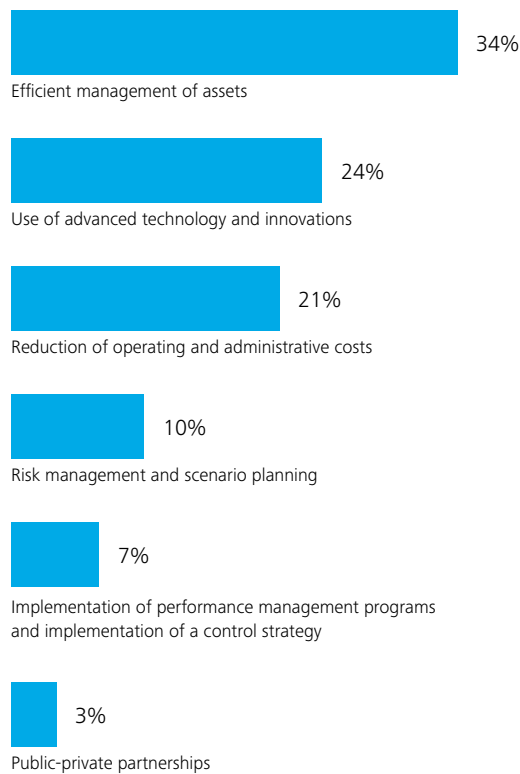
50% of respondents plan to step up investments in oil processing activities in 2011, whereas 10% said that they would significantly cut their investments. A significant proportion of respondents (40%) were still uncertain about their plans for the coming year.

What will be your company's approach to managing its assets in 2011?

Compared with the previous year, the surveyed companies have significantly changed their approach to managing their existing assets. While, in 2009, companies were in search of additional core assets at relatively low prices, they are now trying to sell their non-core assets (67%), with only 22% of the companies surveyed considering purchasing additional core assets.

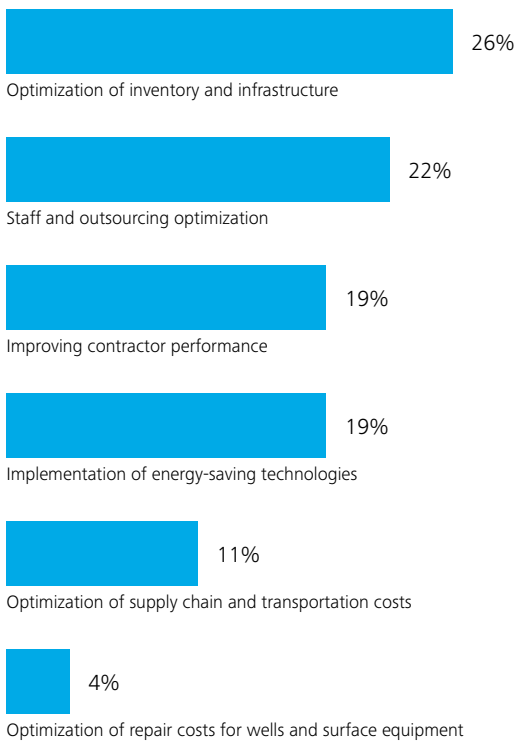


Which of the strategic initiatives listed below do you consider to be the most important for your company to stay competitive:



The companies surveyed selected the efficient management of assets (34%), use of advanced technology and innovations (24%), and reduction of administrative and operating costs (21%), as being the most important measures for improving competitiveness. Compared with last year's results, the use of advanced technology and innovations has significantly increased in popularity. Initiatives such as the implementation of performance management programs and improving the transparency of financial reporting are no longer as popular as previously.

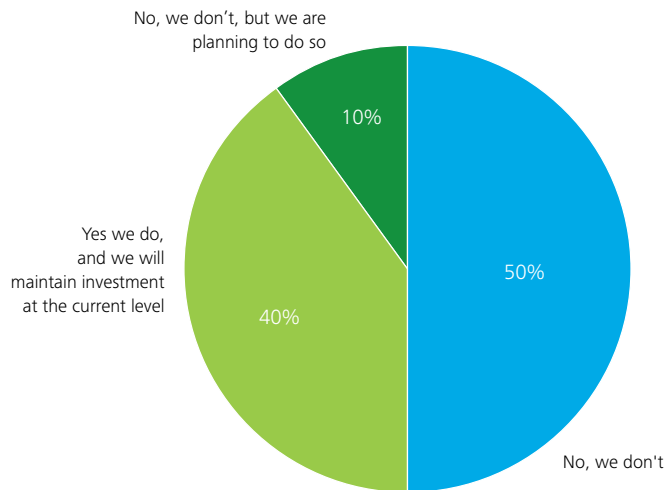
What approach will your company adopt with regard to controlling/reducing operating costs in 2011?



26% of respondents revealed plans to optimize their inventory and infrastructure costs, making this the most popular initiative for controlling/reducing operating costs. Other popular initiatives for controlling/reducing operating costs were the optimization of staff and outsourcing (22%), improving contractor performance (19%) and the implementation of energy-saving technologies (19%). Compared with last year, optimization of inventory and infrastructure, staff and outsourcing optimization, and the implementation of energy-saving technologies have all grown in popularity.

Do you invest in alternative energy research and development?

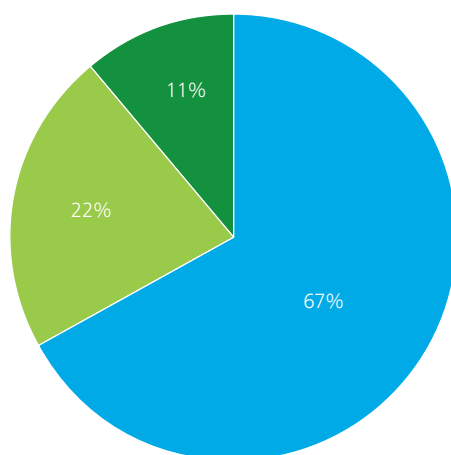
Russian companies need to start investing in alternative energy sources now, in order to be able to compete with foreign energy companies in the future. 50% of respondents stated that they do not invest in alternative energy at this stage, while 10% said that they are considering investments in this area. The remaining 40% are already investing in the development of alternative energy sources and plan to maintain these investments at the current level.



Our respondents

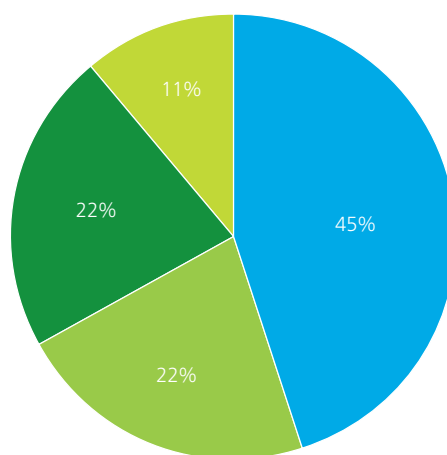
Our survey was conducted among executives at various levels (senior executives, heads of divisions and departments) of companies operating in Russia, and engaged in hydrocarbon exploration, production and processing. The survey covers both local and international vertically integrated companies, as well as independent small and medium-sized businesses. 89% of the respondents were non-state companies.

Your organization is:



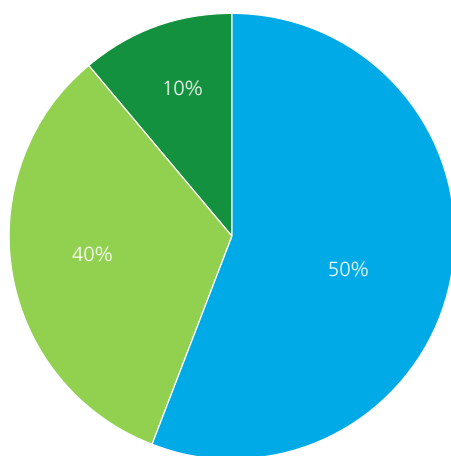
- Public company
- Private company
- State-owned company

Your consolidated annual revenue:



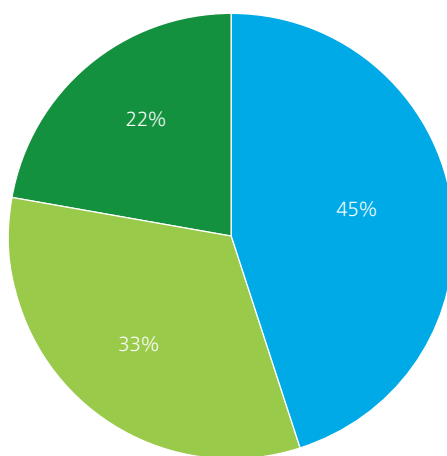
- Over 15bn US Dollars
- 1-15bn US Dollars
- 500m to 1bn US Dollars
- Up to 500m US Dollars

Your operation activities include:



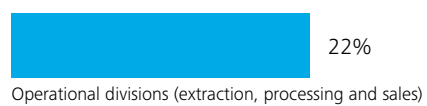
- Processing only
- Production and processing
- Production only

Your position at the company:



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

Your functional area:



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