Deloitte.

2015 Russian Oil & Gas Outlook Survey

Russia, 2015

Introduction

Dear colleagues, we are pleased to present the findings from the 9th annual survey among oil and gas executives and professionals conducted by Deloitte CIS.

As in previous years, the purpose of this survey is to assess interim performance of the sector and the current performance of individual companies, as well as to share the views of executives on the short-term and long-term prospects for business development.

2014 saw significant economic changes in the country. Due to the sanctions imposed by the OECD against Russia and slumping oil prices (up to USD 45 per barrel), fuel-and-energy companies have encountered new issues. Thus, due to the sanctions a number of joint Arctic shelf development projects have been already blocked or will be blocked in the near future. In addition, the sanctions have caused difficulties with high-tech equipment supplies necessary for producing tight oil. Western service companies, which are difficult to replace, are abandoning the Russian market.

As a result of these changes, most participants in the survey forecast lower demand for oil and gas in Russia and an increase in the global demand for gas. Despite a negative trend in the gas and oil demand in Russia, about half of the companies that took part in the survey are planning to keep their asset portfolio unchanged in 2015, while a third of them are going to invest in new core assets. The respondents consider loans and borrowing (44% of the participants) and internally available funds (32%) as their main sources of funding. The need for the latter results from tightened loan conditions due to the sanctions imposed against Russia.

Executive expectations about the level of state regulation in the oil and gas sector continue to grow. Over 70% of the surveyed companies believe that MET differentiation for the production of tight oil reserves is the most conducive tax change for industry development. Just as a year ago, executives are convinced that changing oil product excise rates is also an effective incentive for the development of the oil and gas industry (42% of respondents in favor and 32% against in 2014).

Shortly, the companies will feel the impact of the issues caused by the imposed sanctions. However, they could also have a positive effect. Constrained supplies of Western oil and gas equipment are likely to prompt the recovery of the Russian manufacturing industry that produces complex equipment for the oil and gas industry. The same applies to potential development of the Russian oil service companies. At the same time, the need to raise long-term loans can be an incentive for the development of the Russian loan system for oil and gas projects.

We would like to thank everyone who took part in our survey and shared their vision of the current state and prospects of Russian oil and gas industry development. I hope that you find this survey useful and interesting.

We wish our readers all the best in 2015 and hope their business will overcome any possible difficulties.

Elena Lazko
Partner
CIS Oil and Gas
Leader

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Our respondents

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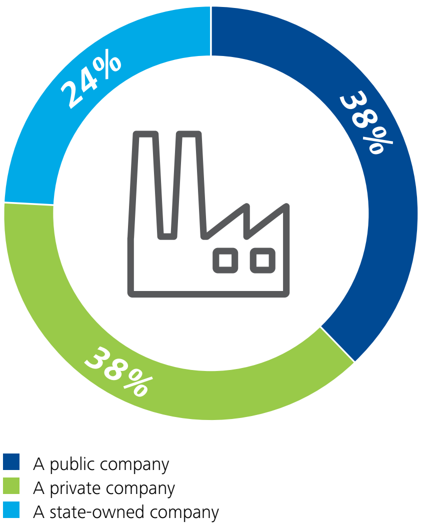
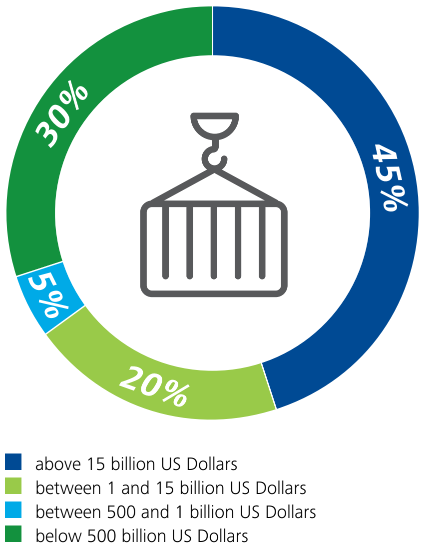
The Survey was conducted among various executives (such as top managers, head of divisions, department directors and heads of functions) at companies involved in hydrocarbon exploration, production and processing, as well as service companies. The survey covers large local and international, vertically-integrated companies and independent small and medium-sized businesses. 76% of the surveyed companies belong to the private sector.

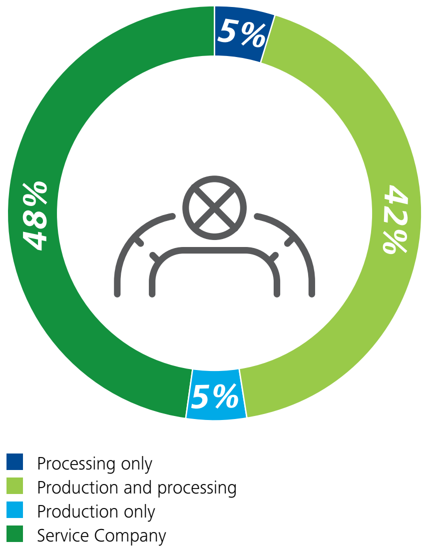
TYPE OF OWNERSHIP



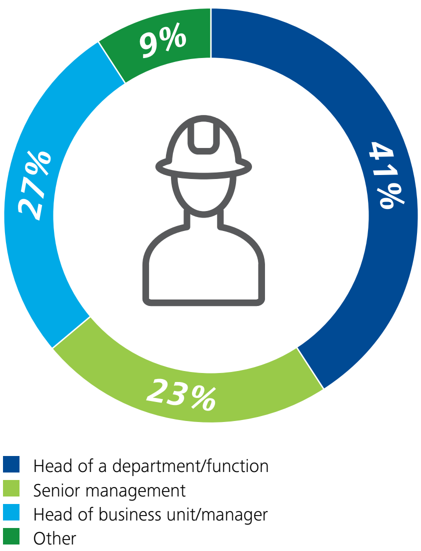
CONSOLIDATED ANNUAL REVENUE



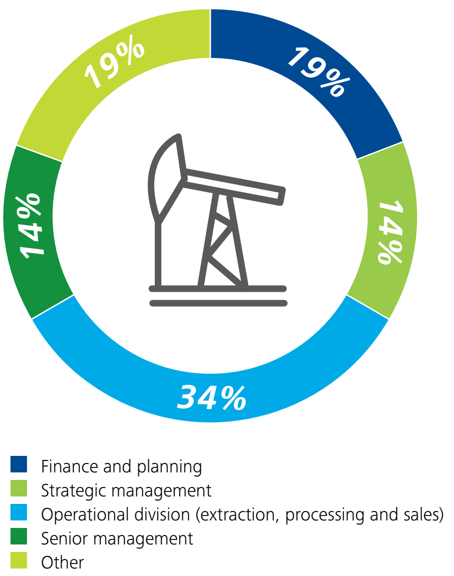
BUSINESS MODEL



POSITION



FUNCTION

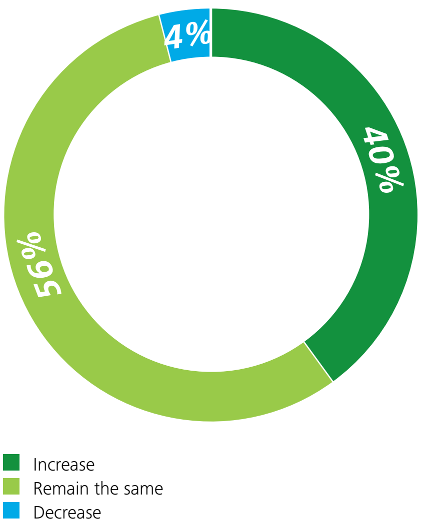


2015 Russian Oil & Gas Outlook Survey

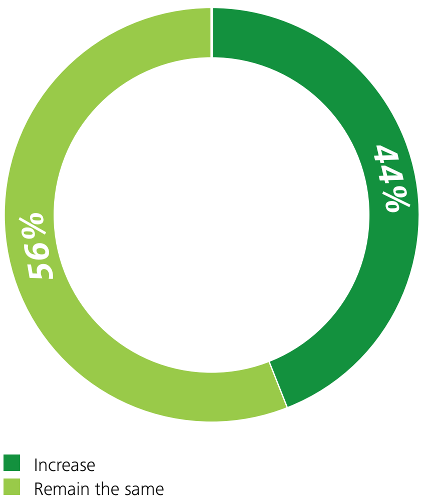
Survey results

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

DOMESTIC DEMAND FOR OIL WILL

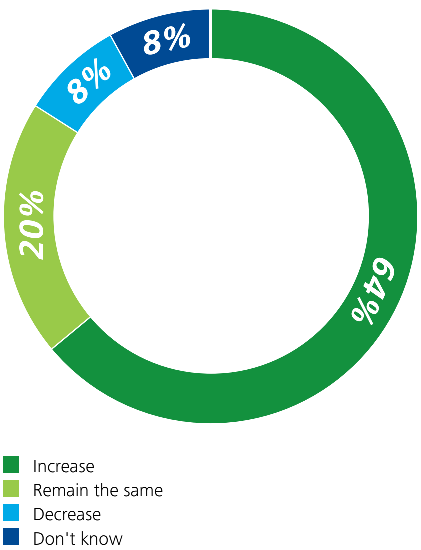


DOMESTIC DEMAND FOR GAS WILL

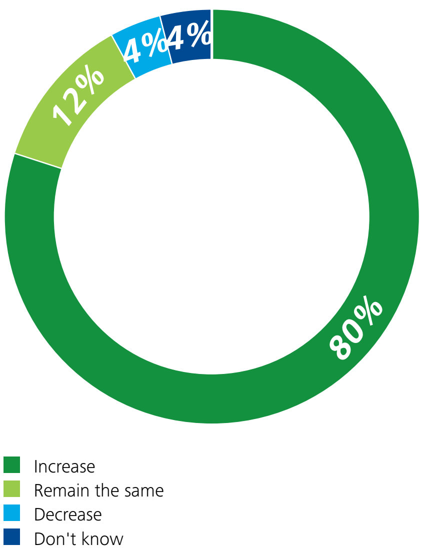


Most interviewees are less optimistic about the demand for oil and gas in 2015 than they were a year ago. Only 40% of the surveyed participants expect the demand for oil to grow, while last year 69% were inclined to share this view. 56% of the participants believe that oil and gas consumption will remain unchanged. Forecasts for the Russian gas market are virtually identical: 44% of the respondents expect the demand for gas to grow in Russia (2013 – 63%). The number of the respondents that believe that oil demand will shrink is only 4%. None of the respondents thinks that gas demand will decline.

GLOBAL DEMAND FOR OIL WILL

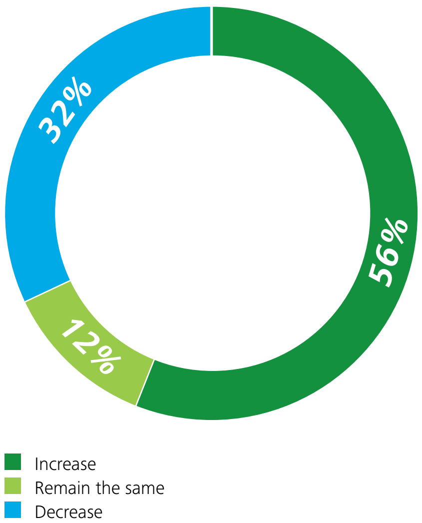


GLOBAL DEMAND FOR GAS WILL



The number of the surveyed participants that believe that global demand for oil will rise has decreased to 64% (in comparison with 71% a year ago). The number of respondents expecting an increase in gas demand has grown from 76% to 80%.

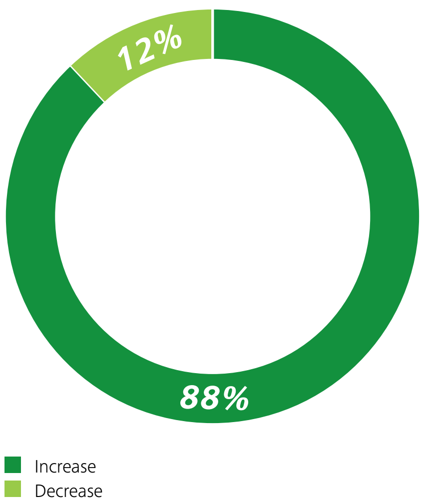
Compared with the current price, oil prices in 2015 will:



44% of the respondents predicted an increase in oil prices, while 37% of the participants expected that the level of oil price would remain the same, and only 19% were inclined to think it would drop.

The expectations of most experts about change in the oil price level have not been met. Thus, during 2014 the average price of Brent grade oil dropped by more than USD 40, and today it is less than USD 45 per barrel. However, most respondents (56%) are optimistic and believe that the oil price will increase in 2015; a drop is forecasted by 32% of the surveyed, and only 12% of them say it will not change.

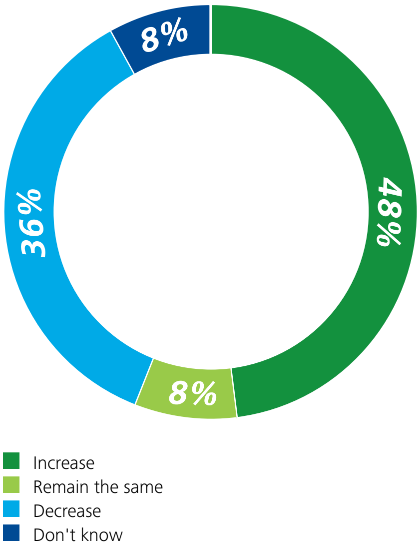
Over the next 5 years, demand for capital in the Russian oil and gas industry will



Currently, there is a tendency to increase capital investment due to the depletion of many unique and large high-yielding deposits, their high water intrusion, and discovery and exploration of tight oil reserves.

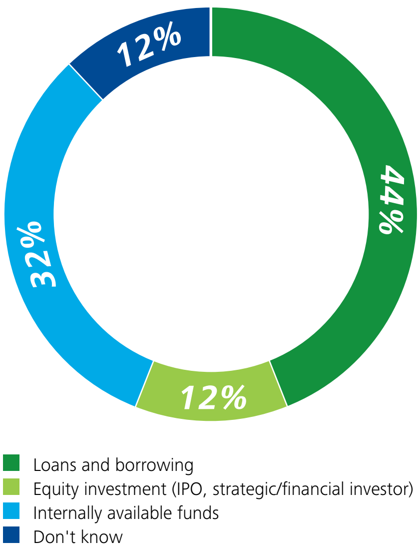
88% of the respondents (the same percentage as a year ago) believe that the Russian oil and gas sector's need for capital will grow over the next 5 years, and only 12% predict that the volume of investment in the Russian oil and gas sector will remain unchanged.

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



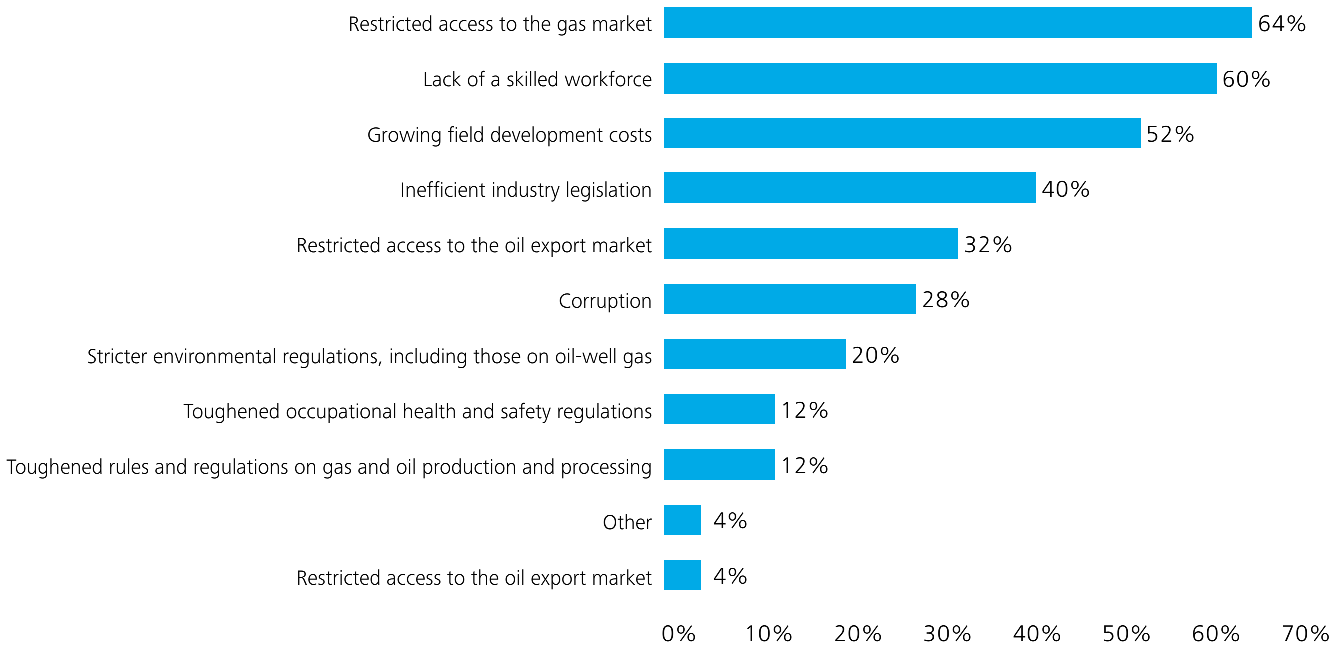
This year, the forecast for capital inflow into the Russian oil and gas industry is less optimistic compared to the previous year. 48% of the respondents presume that the inflow of capital will increase, while in 2013 this percentage was 56%. In addition, the number of respondents expecting the inflow of capital to shrink has increased significantly (36% vs. 12% last year). The views of the respondents were also affected by the imposed sanctions and an unfavorable investment climate in Russia, which resulted in freezing foreign direct investments in the 3rd quarter of 2014, which comprised USD 1 billion.

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



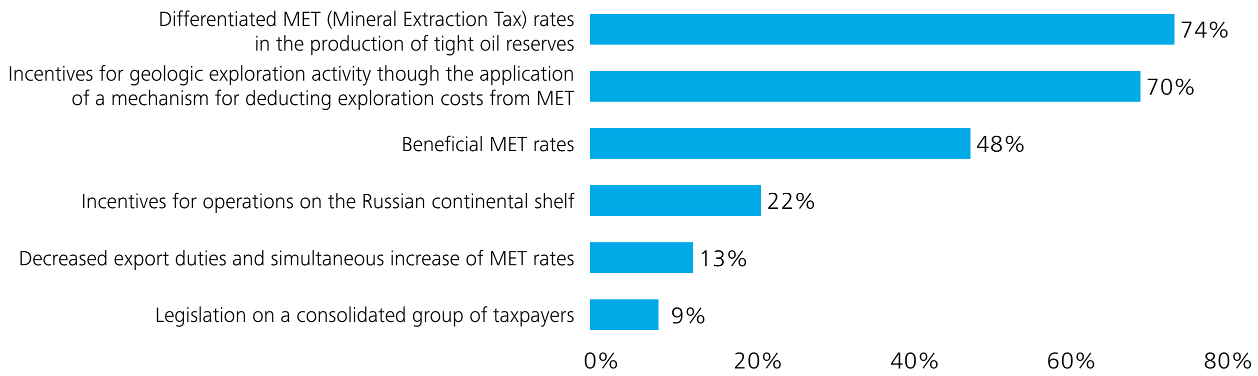
Over the last two years, the views of the respondents on possible sources of capital has changed: while in 2013, 37% of the respondents were ready to consider third-party loans as the main source of capital while in late 2014 this figure went up to 44%. In 2015, giving their forecast for the next five years, 32% of the respondents said they are going to finance large projects from internal sources (for comparison, in 2013 the number was 27%). This is due to the fact that, in the current geopolitical environment, access to long-term credit facilities via European and American banks is restricted.

In your view, what could be the most serious problems encountered by oil and gas companies?



64% of the respondents named restricted access to capital the main issue for the oil and gas industry. Another 60% believe that the lack of a skilled workforce is having a strong impact on the operations of oil and gas companies. Growing field development costs is also a significant factor, according to 52% of the respondents. The least significant issue was restricted access to the oil export market, with only 4% of respondents seeming to worry about it.

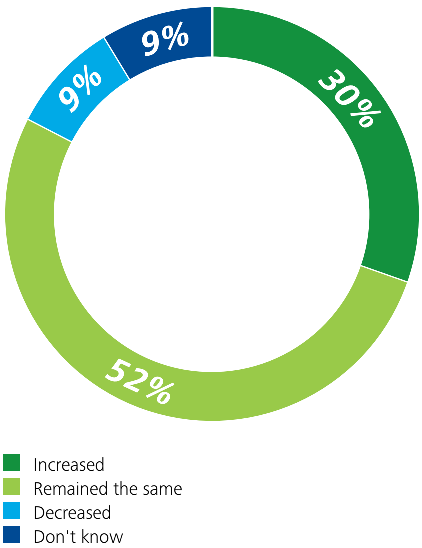
The tax benefits and tax adjustments the industry will most benefit from are (please select):



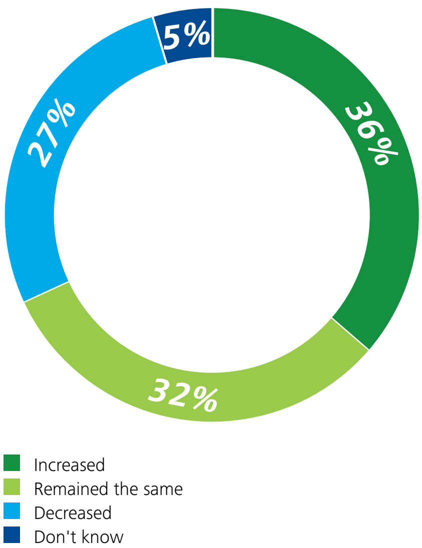
Due to the depletion of light oil reserves and the increasing need to work in remote areas, the respondents flagged differentiation of MET for tight oil reserves as the most favorable tax factor for industry development (74% of the respondents). In addition, survey participants note the incentive for geological exploration through the application of a mechanism for deducting exploration costs from MET and the introduction of beneficial MET rates (70% and 48%, respectively) among meaningful incentives.

In 2014, your headcount has:

HEADQUARTERS
MANAGEMENT

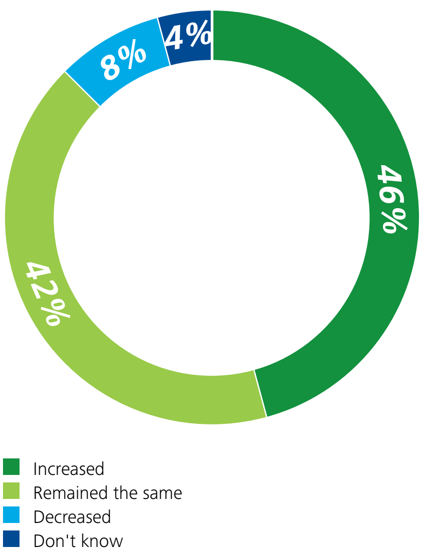


HEADQUARTERS
PROFESSIONAL AND ADMINISTRATIVE STAFF

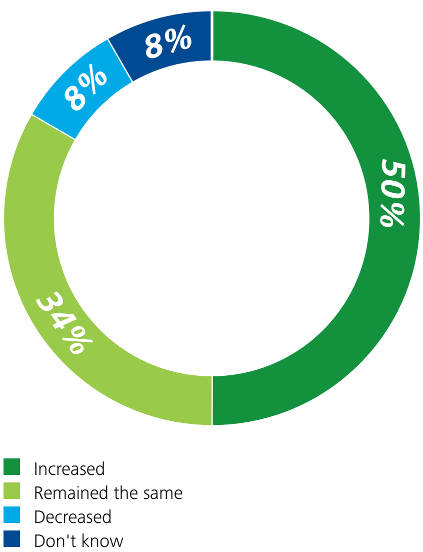


Most respondents (52%) pointed out that the number of management-level personnel at headquarters remained unchanged in 2014 (for comparison that number in 2013 was 59%). 30% noted an increase in the number of management level personnel (last year – 33%) and 36% in the number of professionals (last year – 78%). 27% of the respondents noted a decrease in the number of professional and administrative staff.

PRODUCTION UNITS
MANAGEMENT, PROFESSIONAL AND ADMINISTRATIVE STAFF



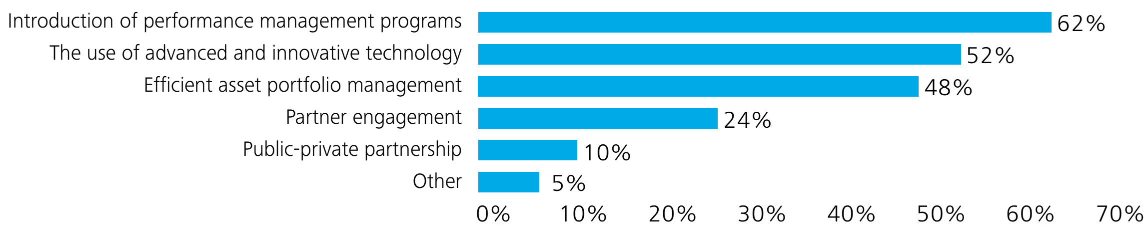
PRODUCTION UNITS
BLUE-COLLAR STAFF



46% of industry professionals indicated an increase in production unit staff at the manager, professional and administrative level. 42% of the respondents stated that the headcount remained unchanged, and only 8% indicated a decrease.

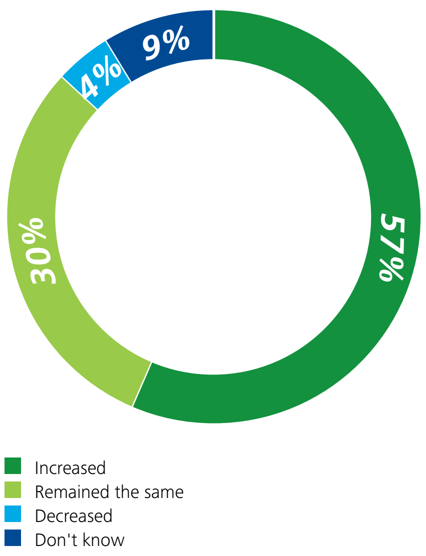
With regards to blue-collar staff, 50% of the respondents noted that their number had increased. 33% reported no changes and 8% noted a decrease in blue-collar staff in production units.

In your view, which of the strategic initiatives listed below are the most important for your company to remain competitive?



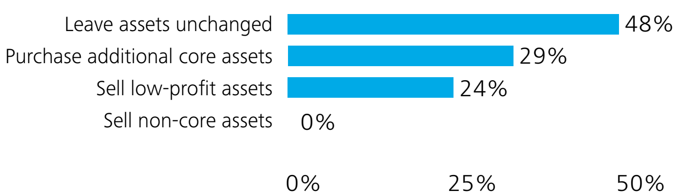
The implementation of performance management programs (62% of the respondents), the implementation of the latest technology and innovation, and efficient management of the asset portfolio (52% and 48%, respectively) are seen as the most important incentives.

In 2014, your production assets have:



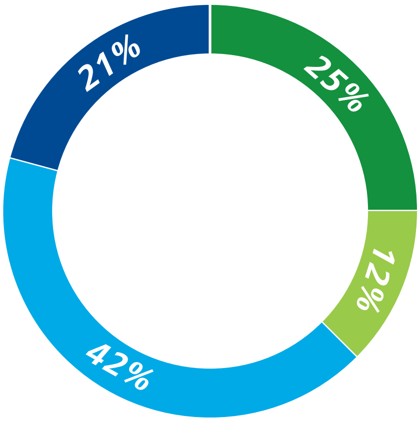
Like a year before, the respondents report an increase in their company assets (57%). At the same time, 30% of the respondents believe that their asset portfolio remained the same and only 4% of the surveyed indicate a reduction in portfolio assets.

What plans does your company have for asset management in 2015?



In 2015, most companies (48%) do not plan to change their asset portfolio (last year this figure was 38%). At the same time, 29% of the companies are considering purchasing additional core assets. 24% of companies noted that they were planning to sell low-profit assets.

Which of these events do you think will have the greatest impact on oil processing companies?



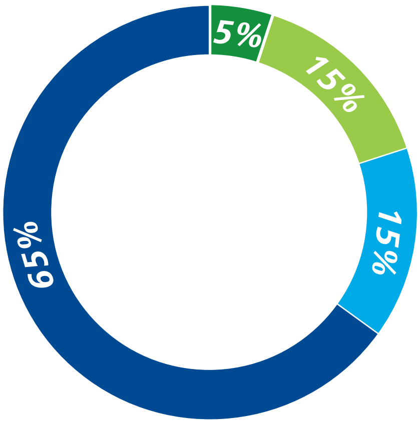
Like a year ago, most respondents (42%) believe that a change to excise rates is the most stimulating measure for the development of the oil and gas industry (last year – 32%). Approval of the General Development Plan for the Russian Oil Sector is also a significant factor influencing industry development (2014 – 25%; 2013 – 28%). The adoption of Euro 5 is not seen as a driver of oil and gas industry development, mentioned by just 12% of the respondents.

- Approval of the General Development Plan for the Russian Oil Sector
- Adoption of Euro 5
- Changing oil-product excise rates
- Other

Compared with 2014, which of the following operational areas are you planning to expand or cut back on in 2015?

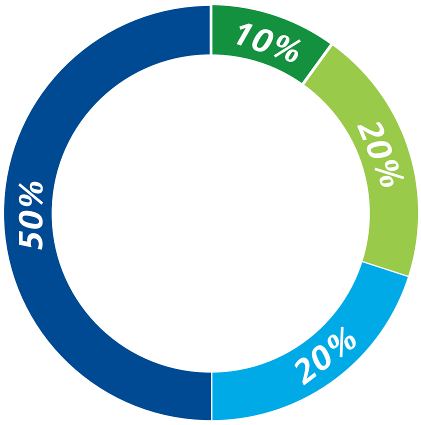
EXPLORATION

SEISMIC SURVEY — THE LEVEL OF EXPENDITURE ON SEISMIC EXPLORATION IN YOUR COMPANY WILL:



Increase
Remain the same
Decrease
Don't know

EXPLORATORY DRILLING – THE LEVEL OF EXPENDITURE ON EXPLORATORY DRILLING IN YOUR COMPANY WILL:

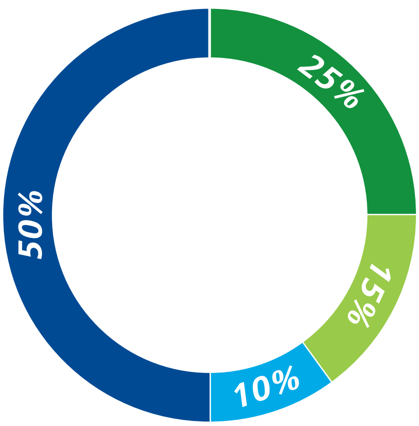


Increase
Remain the same
Decrease
Don't know

In 2015, an insignificant share of companies are planning to increase the level of expenditure on seismic survey and exploratory drilling (5% and 10%, respectively). On the contrary, a decrease in seismic exploration investment is planned by 15% of the companies, while 20% are planning to invest into exploratory drilling. The majority of respondents could not answer definitely (65% and 50%).

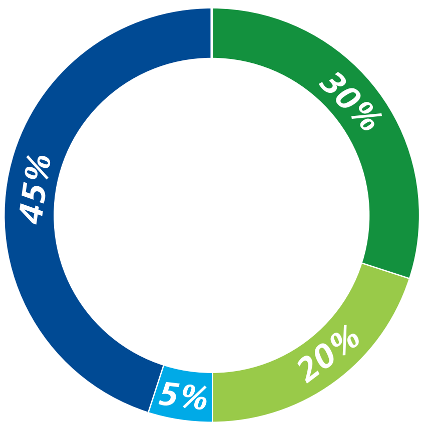
UPSTREAM

DRILLING — THE LEVEL OF EXPENDITURE ON DRILLING OPERATIONS IN YOUR COMPANY WILL:



Increase
Remain the same
Decrease
Don't know

EFFICIENT FIELD DEVELOPMENT — THE LEVEL OF EXPENDITURE ON EFFICIENT FIELD DEVELOPMENT IN YOUR COMPANY WILL:

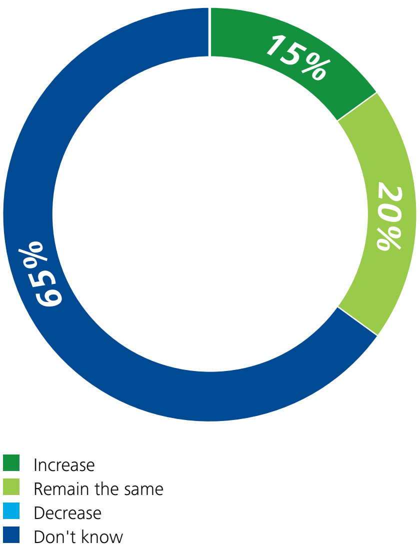


Increase
Remain the same
Decrease
Don't know

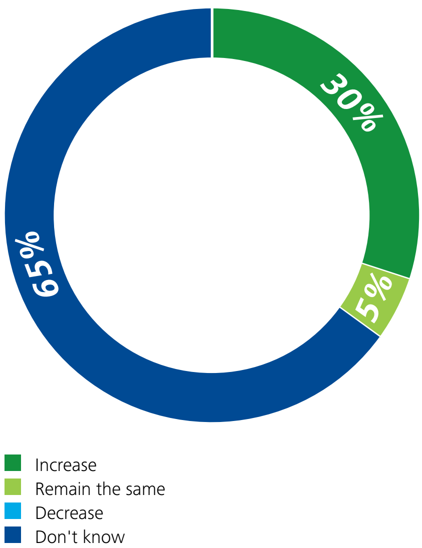
Plans for production expenditures seem more optimistic. 25% of the industry professionals indicated a reduction of investment in drilling and 30% in efficient field development. The intention to reduce expenditure on upstream is less marked than that to cut back on exploration expenses: 10% plan reduced expenditure on drilling, while 5% plan reduced expenditure on efficient field development. About a half of the respondents could not give a definite answer as well.

MIDSTREAM

TOTAL PROCESSING CAPACITY — THE LEVEL OF EXPENDITURE ON PROCESSING CAPACITY IN YOUR COMPANY WILL:



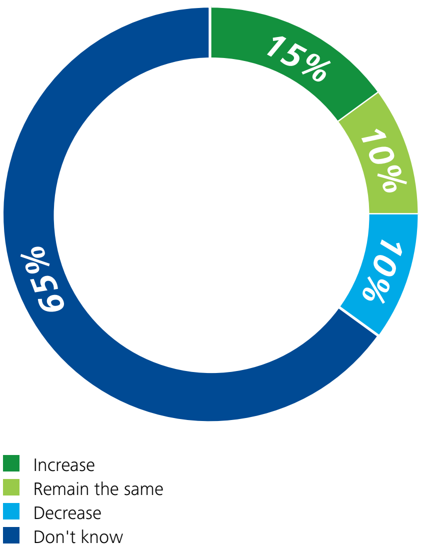
REFINING EFFICIENCY — THE LEVEL OF EXPENDITURE ON IMPROVING REFINING EFFICIENCY IN YOUR COMPANY WILL



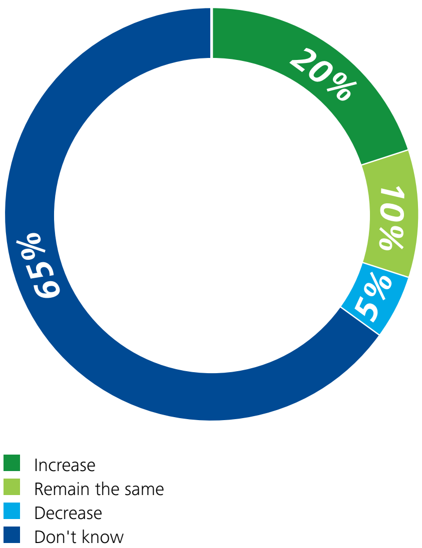
In exploration, upstream, midstream and downstream, the share of companies planning to increase expenses is low. The intention to invest in aggregate capacity and depth of oil processing is expressed by 15% and 30% of companies, respectively. No one expressed the intention to reduce midstream expenditure.

DOWNSTREAM

NUMBER OF FILLING STATIONS — EXPENDITURE IN THIS AREA WILL:



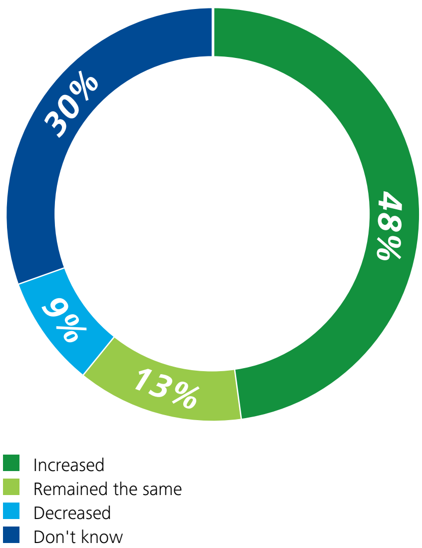
PRODUCT AND SERVICE OFFERINGS — YOUR COMPANY'S EXPENDITURE ON PRODUCT AND SERVICE OFFERINGS WILL:



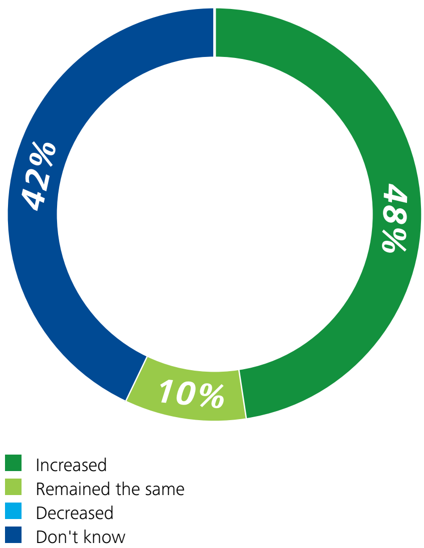
15% of the companies intend to increase expenditure on the construction of new filling stations. 10% plan to reduce this expenditure. 20% are going to ramp up expenditure related to the range of goods and services offered, whereas 5% intend to cut back on it. 10% will keep expenditure at the current year's level.

In 2014, your company's spending in the areas:

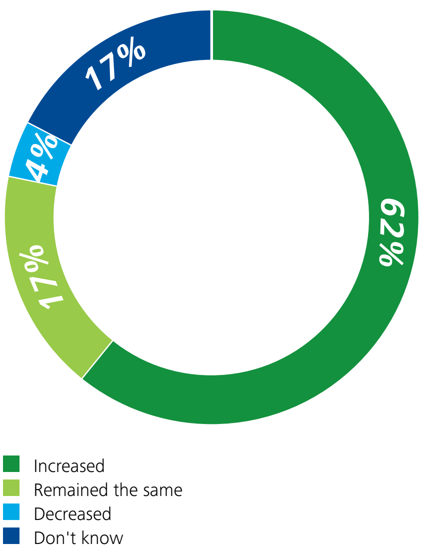
R&D IN OIL AND GAS UPSTREAM



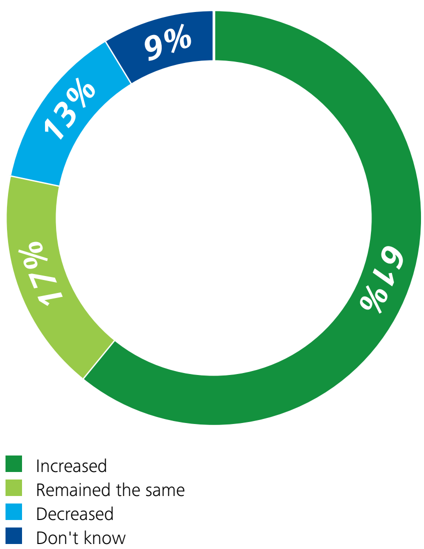
R&D IN OIL AND GAS DOWNSTREAM



CAPITAL CONSTRUCTION PROJECTS



OPERATIONAL ACTIVITIES



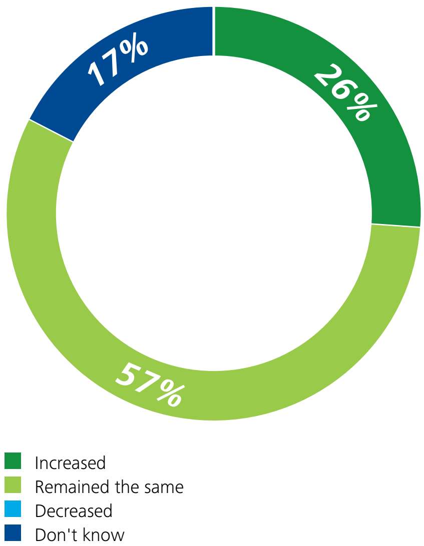
The need to move to remote areas to extract tight hydrocarbon reserves has led to increased expenditure on R&D. 48% of the respondents indicated an increase in R&D expenditure in 2014. 13% believe that expenditure remained at the same level (last year — 53% and 21%, respectively).

48% noted an increase in R&D expenditure in the downstream segment in 2014 (last year — 58%). 43% state their expenditure remained at the same level.

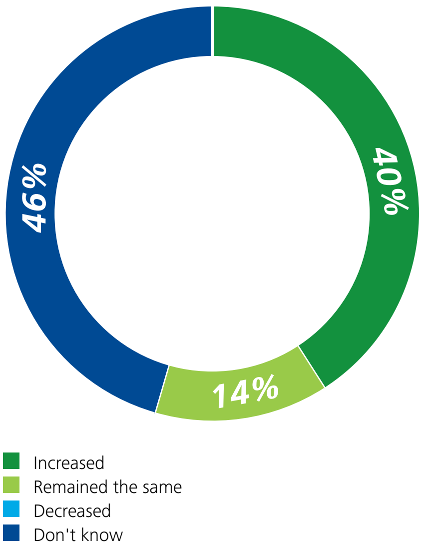
Most companies (61%) increased capital construction volumes in 2014 (compared with 53% last year), whereas 4% reduced them (last year the figure was 5%). 17% of the companies have not changed the level of their expenditure.

In 2014, 61% of the surveyed increased operating expenses, while last year this figure was 67%. 17% of the respondents indicated no changes and 13% noted a decrease in their operating expenses.

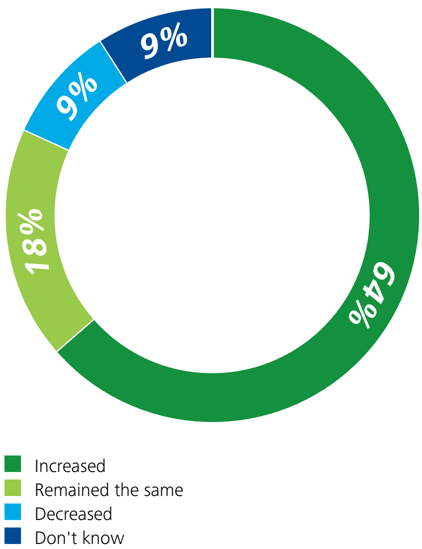
SOCIAL PROGRAMS



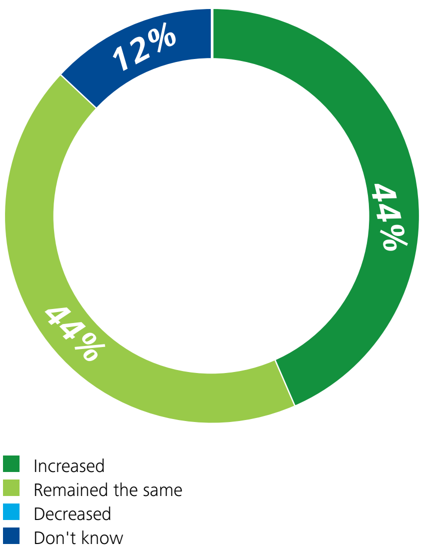
ENVIRONMENTAL EXPENDITURE, INCLUDING ASSOCIATED GAS UTILIZATION



STAFF EXPENSES



OCCUPATIONAL HEALTH AND SAFETY



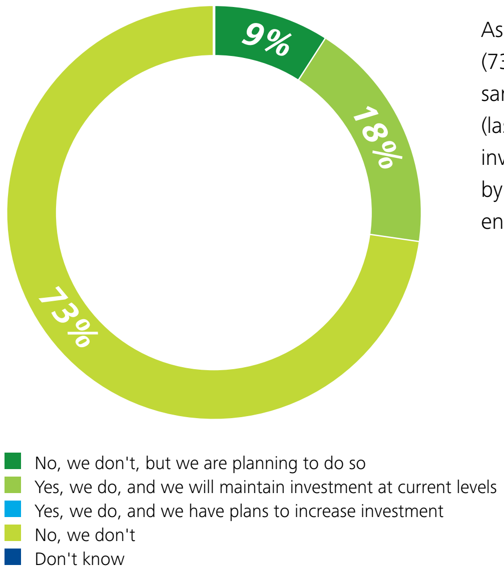
57% of the surveyed said that social program expenditure remained at the same level. Only 26% reported an increase in this item of expenditure, which is equal to last year's share — 25%. None of the respondents noted a reduction in social program expenditure.

Environmental expenditure (including associated gas utilization) was increasing at the same pace for a number of years on end. However, in 2014, only 41% of the companies noted an increase in environmental expenditure (previous periods — over 50%). This could be due to the fact that the companies have met the requirement to utilize 95% of associated petroleum gas that took effect on 1 January 2012, having invested in the modernization of their production facilities and then redirected their investments in other areas.

The survey also showed that expenditure on staff expenses has increased. This was stated by 64% of the respondents. This is likely to be due to an increased share of tight oil reserves, which increases professional qualification requirements. 18% of the surveyed believe that staff expenditure has not changed and only 9% report its decrease.

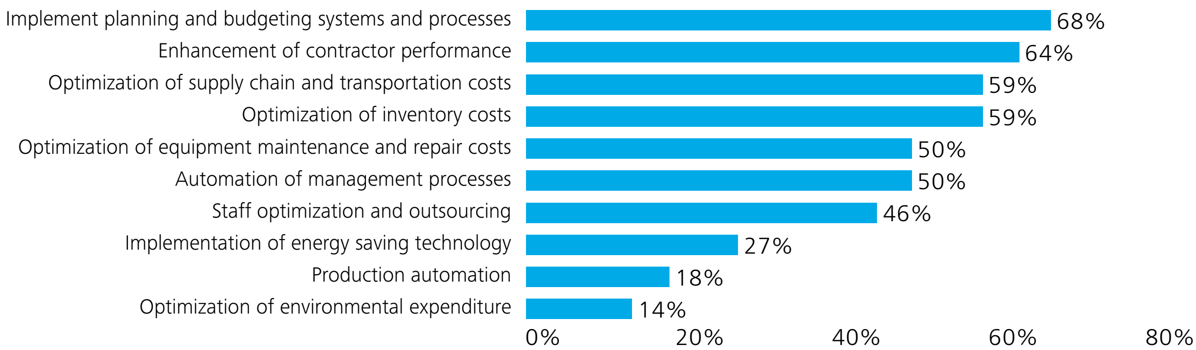
44% noted an increase with regards to occupational health and safety expenditure. The same share of respondents believe that this expenditure has not changed. None of the respondents noted a decrease in expenditure in this area.

Do you invest in research and development of alternative energy sources?



As a year ago, most companies do not invest in the development of alternative energy sources (73%). Only 18% invest in this area and plan to keep the same level of investment. At the same time, 9% intend to start investing into development of non-conventional energy sources (last year this figure was 33%). Despite a decreasing number of companies planning to start investments in alternative energy sources, the need for their development is determined by the depletion of hydrocarbon reserves, increasing complexity of their extraction and new environmental requirements.

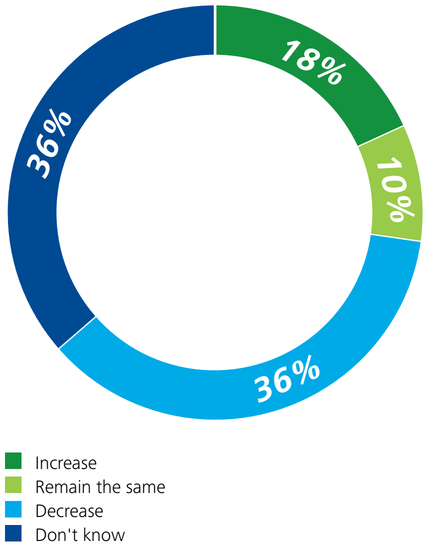
In 2015, what will be your company's approach to controlling/reducing operating expenses?



68% of the respondents named planning and budgeting processes and systems as the most critical method of control over operating expenses. 64% noted enhancement of contractor performance as a significant factor, and 59% of the surveyed believe that optimizing inventory and supply chain and transportation costs contributes to a decrease in operating costs. Only 14% intend to optimize environmental expenditure.

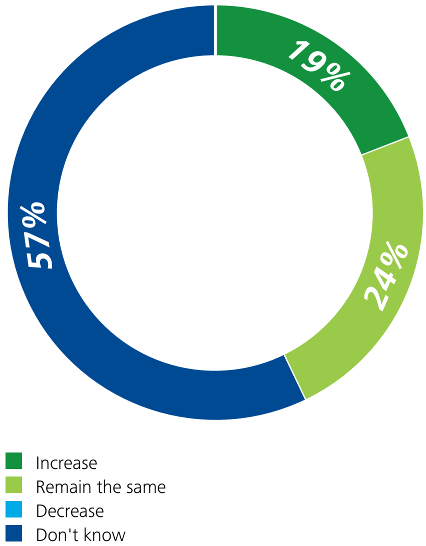
Compared with 2014, which of the operational areas specified below are planned for expansion or cut-back in capital investments in 2015?

YOUR COMPANY'S EXPENDITURES ON PURCHASING INVENTORIES WILL:



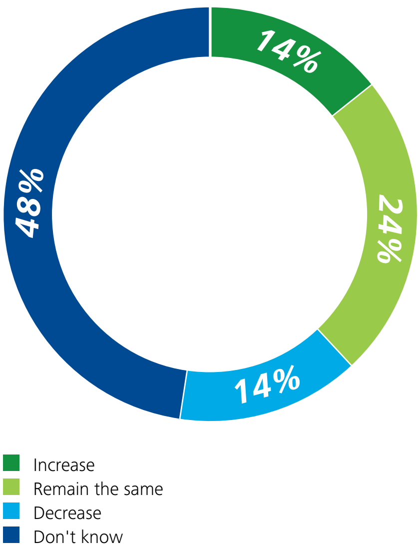
18% of the respondents plan to increase their investment in new assets (last year — 50%). 36% confirmed their intention to decrease new asset expenditure, which is also due to the current economic situation. Last year this figure was only 14%.

THE LEVEL OF FIELD DEVELOPMENT ACTIVITY IN YOUR COMPANY WILL:



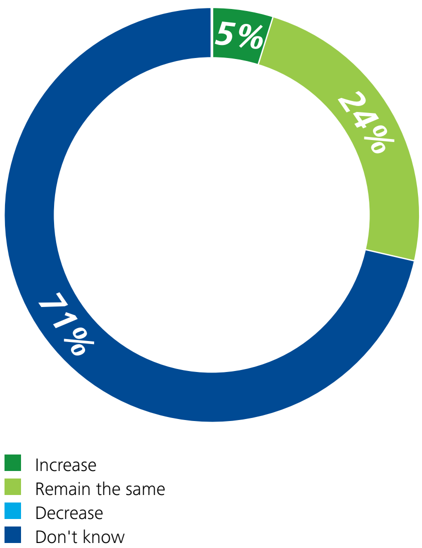
Only 19% of the surveyed managers noted that they planned to ramp up field development expenditure. Last year, 44% of the companies intended to increase this expenditure. However, no one noted a planned decrease in this area.

THE LEVEL OF EXPENDITURE ON EXTRACTING ACTIVITIES BY YOUR COMPANY WILL:



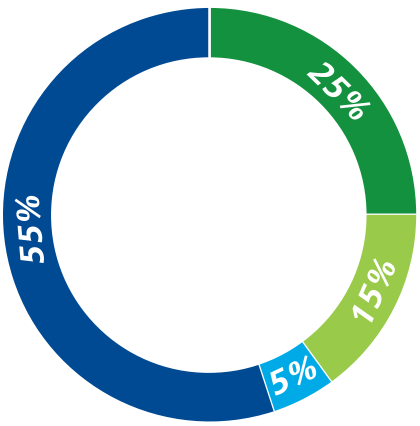
Only 14% of the companies are interested in stepping up production costs (last year this answer was chosen by 30% of the respondents). The same percentage of the respondents plan to reduce this expenditure. 24% of managers said that the level of expenditure would remain at the current year's level (last year — 35%).

THE LEVEL OF EXPENDITURE ON REFINING ACTIVITIES BY YOUR COMPANY WILL:



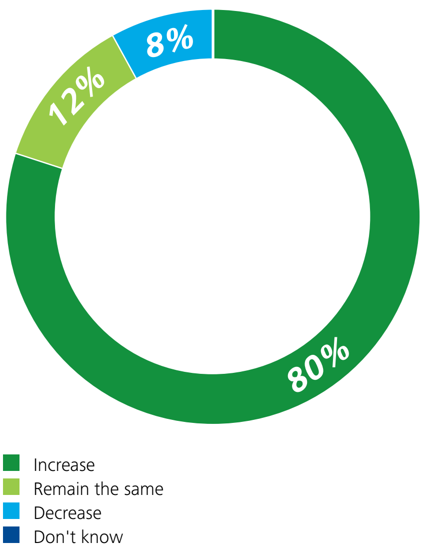
Only 5% of the respondents noted that their companies plan to ramp up expenditure on refining activities in 2015 (last year — 39%). 24% of the surveyed believe that the level of expenditure will remain unchanged. 71% did not give a definite answer to the question. This could also stem from a high level of uncertainty in the current economic situation.

THE LEVEL OF EXPENDITURE ON EXPANDING SALES BY YOUR COMPANY WILL:

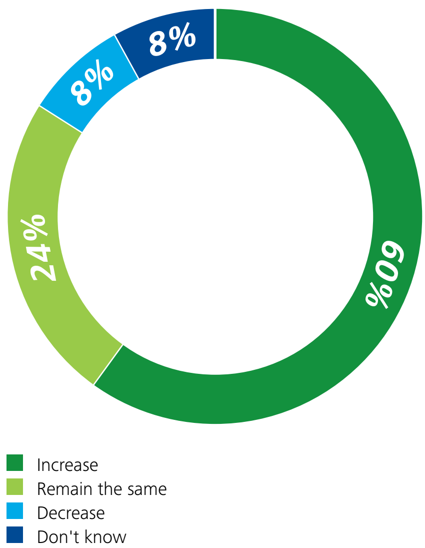


25% of companies plan to ramp up expenditure on expanding sales, which is 3% less than last year. 15% are planning to maintain their expenditure at the same level (last year — 28%).

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



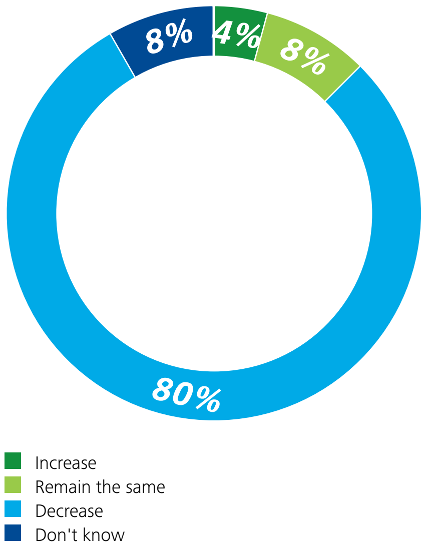
Over the next 5 years, state regulation of the oil and gas industry will:



Most experts believe that in the short-term the participation of state-owned companies in the industry will increase. This is forecast of 80% of the respondents (last year this figure was 58%). This may be due to the fact that in accordance with technical regulation, oil companies must complete an upgrade of their facilities by 2016 and switch to production of modern types of fuel. Only 8% of the respondents indicated a decrease in the participation of state companies in the industry.

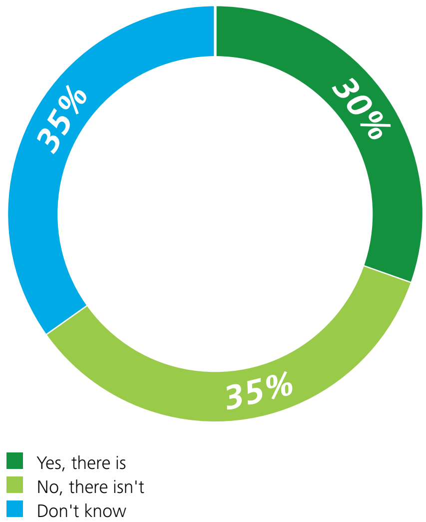
As compared to the previous year, we have observed an insignificant reduction in the number of respondents who note an increase in the level of state regulation of the gas and oil industry (60% vs. 63% last year). 24% believe that this figure will remain unchanged and only 8% of the respondents anticipate a decrease in the level of state regulation (20% and 7%, respectively, last year).

How will foreign participation in oil and gas projects change in 2015?



Most companies (80%) feel that the share of foreign participation in oil and gas projects will decrease. Due to the current geopolitical environment and sanctions imposed against Russia, foreign oil companies are less likely to participate in Russian oil and gas projects.

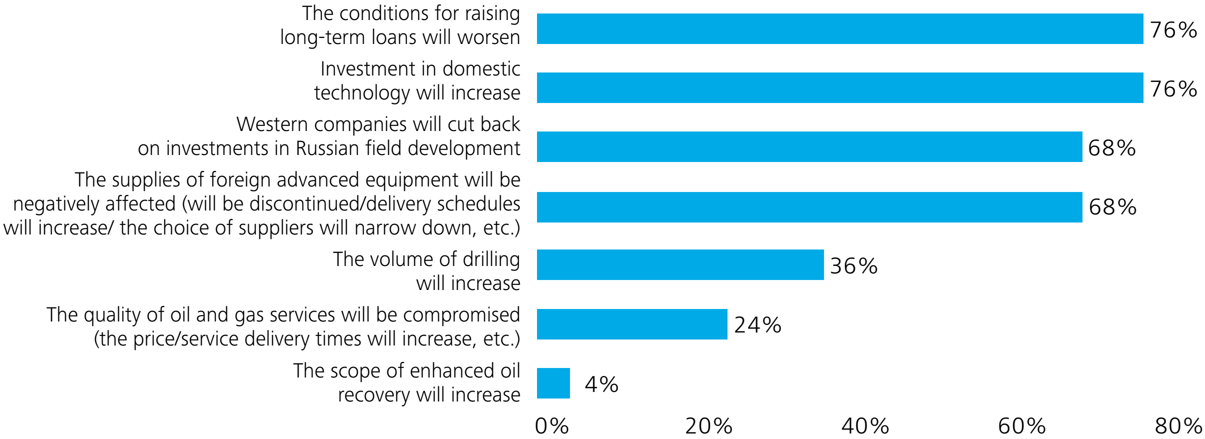
Do you think there is a need to go back to using product sharing agreements (PSA) in the development of the Russian continental shelf?



30% of the participants believe that there's a need to go back to using product sharing agreements in the development of the Russian continental shelf. Last year, this figure was 32%. Another 35% of the respondents stick to the opposite view and believe that there's no need (last year – 26%).

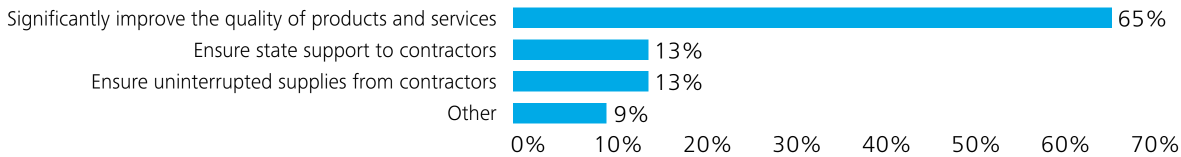
The remaining 35% of industry respondents did not comment on it.

What short-term effect might the sanctions have on the Russian oil and gas industry?



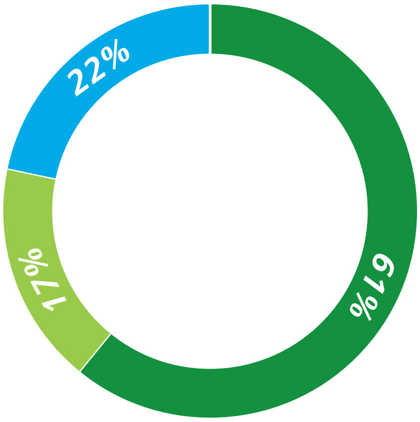
76% of the respondents believe that the sanctions against Russia will lead to increased investment in the development of domestic technology. 76% of the surveyed expect long-term loan conditions to worsen. Many interviewees believe that supplies of foreign advanced equipment will be negatively affected and the volume of Western company investment in the development of Russian fields will decrease (68% and 68%, respectively). The respondents named an increased scope of enhanced oil recovery as the least likely outcome (4%).

What do you think needs to be done to increase participation by domestic contractors in oil and gas projects?



As a year ago, most (65%) survey participants note that Russian suppliers could gain a much bigger share in oil and gas projects if there was significant improvement in the quality of goods and services. According to 13% of the surveyed (last year — 33%), state support is a critical factor for enhancing confidence in Russian contractors. 13% believe that the share of Russian contractors in oil and gas projects will increase if they can ensure uninterrupted supplies (last year — 11%).

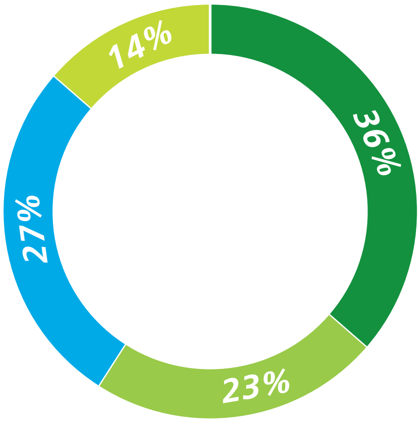
Is there a need for the creation of a unified public database of oil and gas contractors?



- Yes, there is
- No, there isn't
- Don't know

Most respondents (61%) indicated a need to form a unified public database of oil and gas contractors (last year — 71%). As in the previous year, 17% of the respondents believe that there no need for such a database.

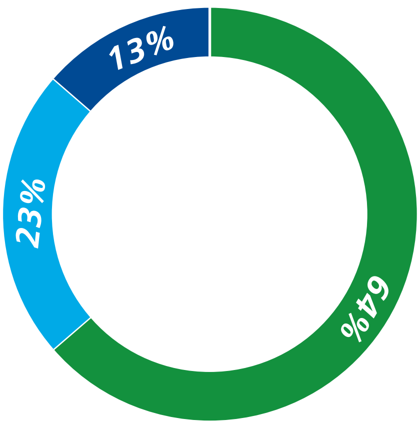
What key procurement risks does your company face?



- Contractual failures by supplies (shipment delays, inadequate quality, etc.)
- Low competition among suppliers, "technological monopoly" of suppliers and an increase in uncompetitive purchase share
- Macroeconomic risks (economic situation, price volatility of exchange traded goods, etc.)
- Regulatory risks
- Other risks

Most of the respondents (36%) have specified contractual failures by suppliers as a key supply chain risk. Last year this figure was 38%. The experts have also named macroeconomic risks as another significant factor (27% and 24% in 2014 and 2013, respectively). Low competition among suppliers is also considered important. This risk was noted by 23% of the surveyed (last year — 14%).

Does your company categorize materials and services procured? Does it apply procurement strategies to these categories?



- Yes it does
- No, but we plan to implement these procedures
- No, it doesn't
- Don't know

The number of respondents indicating that their companies categorize materials and services and apply procurement strategies has grown in comparison with the prior year (64% in 2014 versus 45% in 2013). 23% of the respondents said that this procedure was not applied in their companies. Another 14% of the surveyed didn't answer this question.

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