January 15, 2019

OPEC-led supply pact slows down launch of new oilfields in Russia

Russian oil sector 2023 outlook

- **Launch of new pipeline capacity will trigger a new wave of production growth in the US, which will put pressure on oil prices in 2H2019 and 2020.** ACRA forecasts an average annual price of Russia's flagship Urals oil grade to fall from USD 70.01/bbl in 2018 to USD 63.6/bbl in 2019 and USD 58.7/bbl in 2020.

- **Russia's participation in the supply cuts has led to a slowdown in the commissioning of new fields in Russia.** Oil production in Russia is seen peaking in 2021-2022 and, according to ACRA estimates, peak output will reach 575 million tons per year.

- **Refining growth provides for an increase in exports of oil products.** Exports of motor fuel in Russia will rise by 14.4 million tons in 2017-2023 with refining growing by 15.5 million tons over the same period. The increase in oil production in Russia coupled with a relatively slow pace of refining growth will contribute to the rise in crude oil exports up to 266 million tons in 2022 compared to 256 million tons in 2018.

- **Sanctions didn't cut investment in the Russian oil sector…** Vertically integrated oil companies (VIOCs), excluding state-run Gazprom, will continue to increase investment up to 2020. The spike in oil prices in ruble terms in 2018 has led to a significant growth in EBITDA of Russian oil and gas companies, which contributed to the decline in a CAPEX share in VIOC EBITDA to a rather comfortable level of 54.6%. The debt to VIOC EBITDA ratio fell to 1.3x (basically, the 2013 level) in 2018 compared to 2.3x a year earlier.

- … **but changed the debt structure of oil and gas companies.** The share of the ruble-denominated debt surged from 13% to 41%, and that of bonds from 40% to 66%.

This forecast has been prepared in accordance with [General Principles of Socioeconomic Indicators Forecasting.]

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Table 1. Russian oil sector indicators forecast for 2019-2023

Indicator	Measurement unit	Actual			Estimate	Forecast				
		2015	2016	2017	2018	2019	2020	2021	2022	2023
Production										
Oil and gas condensate production*	mln t	534.1	547.5	546.8	555.8	559.5	568.9	575.0	575.0	573.0
Primary oil processing	mln t	281.9	279.7	279.5	286.1	291.7	295.0	295.0	295.0	295.0
Gasoline production	mln t	39.2	39.9	39.2	39.4	41.1	42.2	42.5	43.0	43.5
Diesel fuel production	mln t	76.0	76.3	76.9	78.3	82.2	84.4	85.0	86.0	87.0
Fuel oil production	mln t	71.5	57.1	51.2	47.9	48.1	48.1	47.2	45.7	44.3
Exports										
Crude oil exports*	mln t	241.3	253.7	256.9	257.5	254.4	260.2	266.0	266.0	264.1
Gasoline exports	mln t	4.7	5.2	4.3	4.3	6.2	7.2	7.5	7.9	8.3
Diesel exports	mln t	51.0	48.6	50.9	54.3	58.5	60.6	61.1	62.1	63.0
Fuel oil exports	mln t	57.2	42.3	39.2	37.7	34.0	34.2	33.5	32.0	30.5
Investment										
VIOC CAPEX, total	RUB bln	3.215	2.898	3.199	3.675	3.814	3.665	3.262	3.215	3.279
VIOC EBITDA	RUB bln	4.627	3.944	4.207	6.727	6.907	7.144	6.687	6.802	6.980
VIOC CAPEX/EBITDA	%	69.5	73.5	76.0	54.6	55.2	51.3	48.8	47.3	47.0
Prices										
Urals price	USD/bbl	51.3	42.3	53.9	70.01	63.6	58.7	60.2	61.7	63.2
92 gasoline retail price	RUB/l	33.1	34.7	36.8	40.3	42.4	44.1	45.8	47.7	49.6
95 gasoline retail price	RUB/l	36.0	37.7	39.9	43.3	45.7	47.6	49.5	51.4	53.5
Diesel retail price	RUB/l	34.7	35.6	38.3	43.4	47.4	49.3	51.3	53.3	55.5

Source: ACRA

* Base case forecast accounts for the extension of a production cut agreement into 2H2019 with the parameters of the deal remaining unchanged. If the agreement is not prolonged, oil production in 2019 should amount to 565.2 mln t, while crude exports are expected to total 260.1 mln t.

Average annual oil prices to fall in 2019-2020 due to the growth in shale oil production, buoyed by launch of new pipelines

The extension of the agreement between producers from the Organization of the Petroleum Exporting Countries (OPEC) and non-OPEC players to curb crude output by 1.2 million barrels per day (bpd) in 1H2019, as well as the cut of 325,000 bpd announced by Canada in early December, 2018, will make it possible to balance the oil market by 2Q2019. However, further growth in US shale oil production may require the extension of the OPEC+ supply deal into 2H2019.

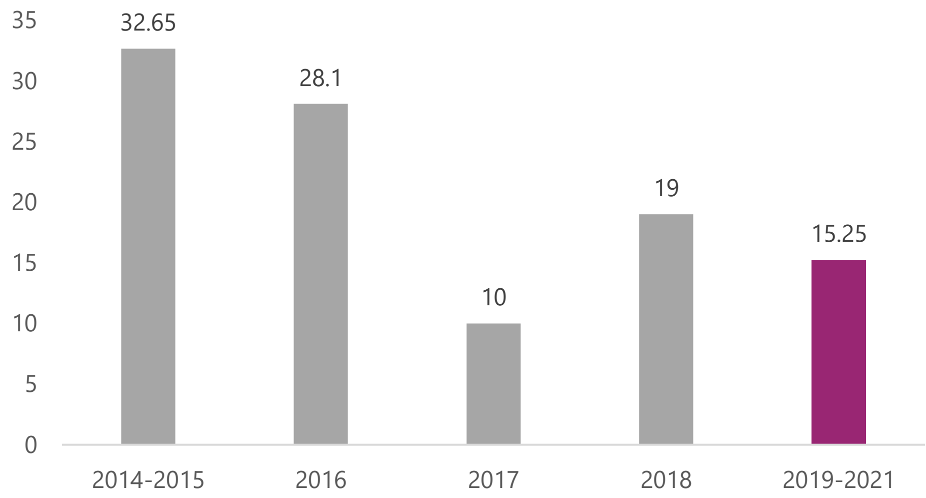
The lack of pipeline infrastructure significantly hampered the growth of shale oil production in the US in the first six months of 2018. The rapid increase in production in the second half of 2018 was only possible thanks to the rise in oil prices, which was sufficient to compensate for the costs of shale oil shipments by rail. However, the launch of the four new pipelines in the second half of 2019, namely Cactus II, Enterprise, EPIC, and Grey Oak, which have a combined capacity of 2.67 million bpd, will help remove transportation-related restrictions on production. By the end of 2020, another three pipelines (Exxon/PAA JV, Jupiter, and Permian-Gulf Coast) with a combined capacity of 2 million bpd will come online. The launch of new pipeline capacity will lead to a new wave of production growth in the US, subsequently putting pressure on oil prices in 2H2019 and 2020. According to the ACRA forecast, the average annual Urals price will fall from USD 70.01/bbl in 2018 to USD 63.6/bbl in 2019 and USD 58.7/bbl in 2020.

Slowdown in the launch of new large fields postpones peak oil production in Russia until 2021-2022

Russia’s participation in the global supply cut agreement led to a slowdown in the commissioning of new fields. Hence, the launch of the Rosneft-owned Russkoye field was postponed from 2017 to the fourth quarter of 2018. Furthermore, the commissioning of the Taas-Yuryakh, Kuyumbinskoye and Tagulskoye fields, scheduled for 2018, also happened only in the fourth quarter of the year. The shift in the deadlines for the launch of new large fields postpones the previously forecasted (See “Russian oil industry to set new records regardless of production freeze talks” as of May 17, 2017) peak oil production in Russia until 2021-2022 with peak output seen at 575 million tons per year, according to ACRA estimates.

Despite the extension of the OPEC+ agreement into the first half of 2019, Moscow’s quota of 11.18 million bpd (considering a gradual decline in average daily production to the set level in the first months of the year) makes it possible to forecast an increase in oil production in Russia to 559.5 million tons in 2019 compared to 555.8 million tons in 2018, and 546.8 million tons in 2017. The base case forecast envisages the extension of the pact on the current conditions until the end of 2019. If the deal is not prolonged, production in Russia in 2019 is forecast at 565.2 million tons.

Figure 1. Total peak production at launched oilfields, mln t



Source: ACRA

Table 2. Schedule for commissioning of new large oilfields (peak production above 1 mln t per year)

Oil field	Company	Launch date	Production plateau, mln t/y
Northern Chaivo	Rosneft	2014–2015	1.6
Labaganskoye	Rosneft	2014–2015	1.25
Srednebotuobinskoye	Rosneft	2014–2015	5.0
Imilorskoye	Lukoil	2014–2015	5.0
Prirazlomnoye	Gazprom Neft	2014–2015	5.0
Novoportovskoye	Gazprom Neft	2014–2015	6.5
Trebs and Titov	Bashneft, Lukoil	2014–2015	4.8
Yarudeyskoye	NOVATEK	2014–2015	3.5
Suzun	Rosneft	2016	6.0
Naulskoye	Rosneft	2016	2.5
Filanovsky	Lukoil	2016	6.0
Pyakyakhinskoye	Lukoil	2016	3.5
Yuzhno-Talakanskoye	Surgutneftegas	2016	1.5
Shpilman	Surgutneftegas	2016	3.0
Vostochno-Messoyakhskoye	Gazprom Neft, Rosneft	2016	5.6
Yurubcheno-Tokhomskoye	Rosneft	2017	5.0
Kondinskaya group of fields (Kondinskoye, West Erginskoye, Chaprovskoye, Novoyendyrskoye)	Rosneft	2017	5.0
Russkoye	Rosneft	2017	6.5
Taas-Yuryakh (2nd stage)	Rosneft	2018	5.0
Kuyumbinskoye	Gazprom Neft, Rosneft	2018	3.0
Tagulskoye	Rosneft	2018	4.5
Lodochnoye	Rosneft	2019	2.0
Sevostyanov, Sanarsky, Lisovsky	Rosneft	2021	10.0
Chona project (Ignyalinskoye, Tympuchikanskoye, and Vakunaiskoye)	Gazprom Neft	2021	3.25

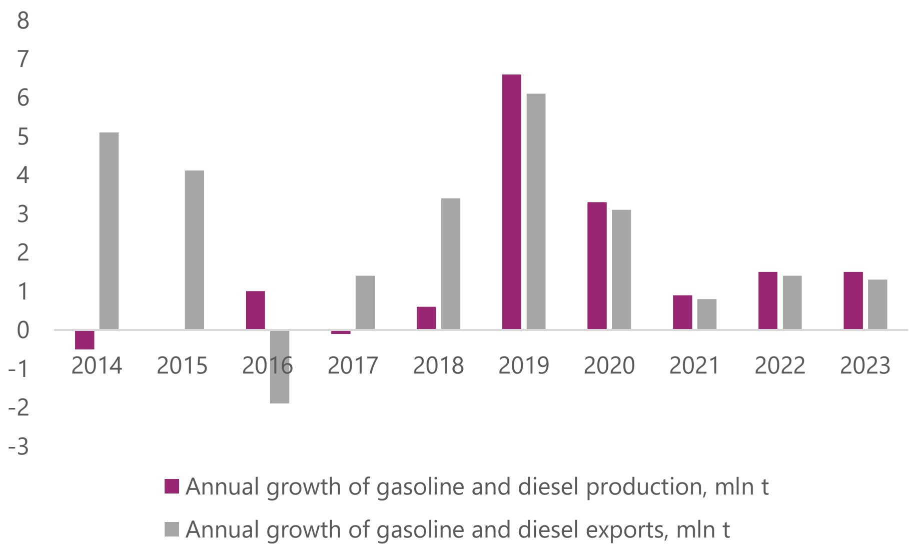
Source: ACRA

Further refinery upgrade to ensure growth of exports of oil products

The implementation of the planned projects on further modernization of Russian refineries will make it possible to ramp up diesel production capacity by 22 million tons per year by 2022, as well as naphtha production capacity by 10 million tons per year.

While additional volumes of naphtha can be absorbed by the domestic market thanks to growing demand, buoyed by the increase in petrochemical production, the rise in motor fuel production, which outstrips domestic demand, will require the growth in its exports.

Figure 2. Growth in production and exports of motor fuel



Source: ACRA

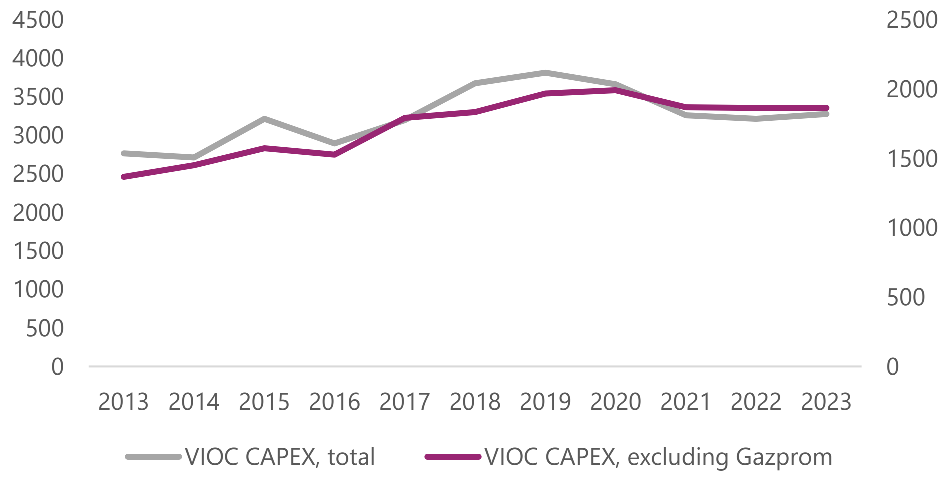
According to ACRA estimates, exports of motor fuel in Russia will rise by 14.4 million tons in 2017-2023 with refining growing by 15.5 million tons over the same period. The increase in oil production in Russia coupled with a relatively slow pace of refining growth will contribute to the rise in crude oil exports up to 266 million tons in 2022 compared to 256 million tons in 2018.

VIOC CAPEX to peak in 2019–2020

Despite the slow-down effect of the OPEC-led deal on the pace of investment growth, Russian VIOCs' CAPEX rose significantly in 2018. According to ACRA estimates, VIOCs, excluding Gazprom, will continue to increase investment up to 2020 (Gazprom's volume of investment will reach its peak a year earlier due to the completion of investment in large pipeline projects).

The spike in oil prices in ruble terms in 2018 has led to a significant growth in EBITDA of Russian oil and gas companies, which contributed to the decline in the CAPEX share in VIOC EBITDA to a rather comfortable level of 54.6%. Additionally, relative debt load decreased too, i.e. the total debt to VIOC EBITDA ratio fell to 1.3x (basically, the 2013 level) in 2018 compared to 2.3x a year earlier. ACRA expects a further decline in this indicator down to 0.77x in 2023.

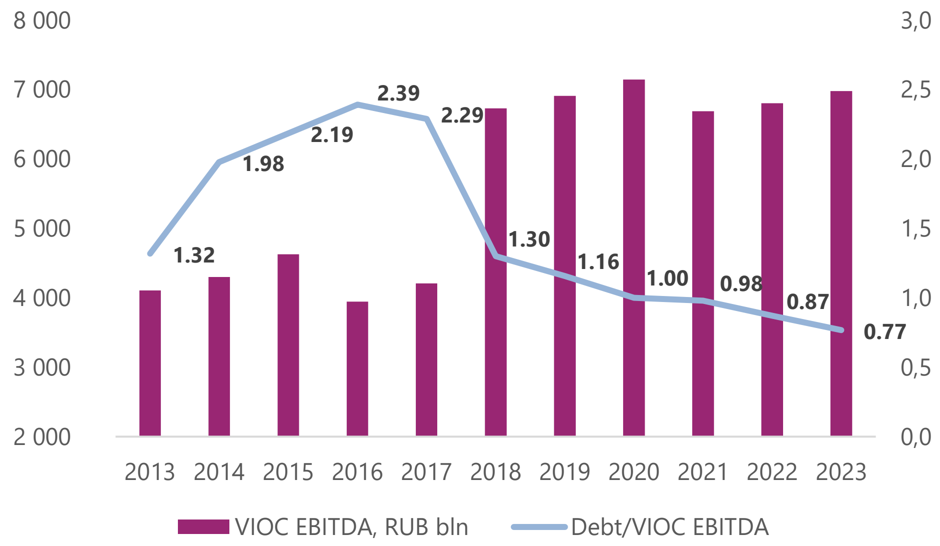
Figure 3. VIOC CAPEX to peak in 2019-2020



Source: ACRA

The introduction of sanctions on Russia had no significant impact on the size of investment but led to a change in the debt structure of oil and gas companies with the share of ruble-denominated loans rising from 13% to 41% and that of bonds from 40% to 66%. The geography of borrowings also changed with the share of US and European banks down and that of Chinese counterparties up.

Figure 4. EBITDA growth and CAPEX decline to lead to a further fall in the debt burden of Russian oil and gas companies



Source: ACRA