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All according to the plan

TAIF is increasing its control over the petrochemical sector of Tatarstan

In November the governmental stock of shares (28.6% of the authorized capital) of one of the largest in Europe petrochemical enterprises – Nizhnekamskneftekhim OJSC, belonging to Svyazinvestneftekhim holding, was assigned for trust management to TAIF Group of Companies. The latter already possesses 25.6% of the shares of this enterprise, so now it has the controlling stock of shares.

Therefore, TAIF, which already owns Kazanorgsintez (the leader of polyethylene production in Russia) and Nizhnekamsk Oil Refinery, gets the control over the whole petrochemical industry of Tatarstan. Apparently this company is turning into the single national vertically integrated oil company. To complete the classical scheme it misses only the oil extraction segment. It is almost certain that this place will be occupied by Tatneft. It all depends on whether the Tatarstan government, a major shareholder of the oil-producing company, will attempt to take control over the «sacred cow» of the Tatarstan economy.



Development Vector

The management company TAIF-NK with its head Robert Khannanov, who was previously Tatneft Deputy Director General charge of petrochemical projects, will manage the development of the petrochemical sector of TAIF business. This subsidiary company will have to provide for the development of the Nizhnekamsk NPZ. Two projects have already been developed, which should provide for the maximum degree of oil refinement and stop the production of black oil. The first project is connected with a complete redevelopment of the bitumen unit bought from Tatneft. It has been recognized as faulty and will be demolished. New equipment will be installed in its place – the initial project has already been prepared. The installation will be put into operation in December 2006.

The second project presupposes the establishment of production for complete refinement of the residuum of the petrochemical production, possibly into carbon black, coke, or granite. The performance specification for this project will be ready by the middle of the next year.

In summer 2005, the Security Council of Tatarstan ordered the companies Tatneft and Nizhnekamskneftekhim, which owned the largest part of the assets of Nizhnekamsk Oil Refinery (NPZ), to provide a long-term lease with the right of purchase to TAIF (see «Quiet redistribution» in «Neft i Kapital» No.8, 2005). TAIF realized its right almost immediately and from September 1st the plant was under its control. Presently all the papers for the transfer of property are being prepared. Sberbank (Savings Bank) of Russia has provided a long-term credit for five years in the amount of \$470 million for the purchase of the above-mentioned property (see «Development Vector»).

Owning NPZ makes TAIF the key player of the Tatarstan petrochemical sector as the plant automatically gives its owner the control over Nizhnekamskneftekhim, for which the straight-run gasoline produced here is the main feedstock.

On-going consolidation

During the last few years naphtha was supplied to Nizhnekamskneftekhim by Tatneft. And at a reduced price, which the chemists made up for by reduced prices on petrochemical raw material provided to Nizhnekamskshina, a controlled oil company. As one would expect, TAIF cancelled the old scheme and set the market

prices. Naturally it increased the self-cost of the products, therefore depriving them of a number of competitive advantages. It was suggested that Nizhnekamskneftekhim management should reduce the expenses not due to over-protection but through increase of the production and management efficiency.

TAIF suggested its own ways to do that. Apparently these recommendations made a good impression on the Tatarstan government, which had great expectations in relation to Nizhnekamskneftekhim for budgetary recharge. Though, just in summer on the annual shareholders meeting Rustam Minnikhanov, Prime Minister of Tatarstan, highly appraised

Gas Condensate will be added

Another project currently realized by TAIF in Nizhnekamsk is the construction of an installation for gas condensate processing (new equipment for the petrochemical industry in Tatarstan) with the capacity of 1-1.2 mln tons per year, with the output of 500 thousand tons of straight-run gasoline and 400 thousand tons of diesel fuel. Putting it into operation, which is planned for the first half of 2006, will completely solve the problem of raw materials provision for the ethylene production of Nizhnekamskneftekhim. After its modernization in 2008 its capacity will increase up to 600 thousand tons per year. At the same time there will appear a problem of its full loading, for the straight-run gasoline produced by Nizhnekamsk NPZ (1.1 mln tons per year) will not be enough. The new installation will provide for the rest.

Shigabutdinov does not consider the supply of raw materials a problem. According to him, the Russian market of gas condensate has been formed and they can choose the suppliers among Gazprom, NOVATECH and oil companies. We could also consider supplies from Kazakhstan. According to TAIF information, about 7-8 tons of gas condensate is currently exported from Russia. The company is planning to participate in this process, signing long-term contracts with suppliers and paying world prices for the raw materials. The same prices will be applied for the sale of the petrochemical products. The marketing research shows that this scheme can be implemented.

The cost of the project comprises \$38 mln. The credit line for three years in the amount of \$34 mln. has been opened by Ak Bars Bank. The pay-back period is three years.

the rates of its development (in 2004 the production output comprised \$1.1 billion and according to the plans presented by Vladimir Busygin, Director General of Nizhnekamskneftekhim, in 2008 this figure shall comprise \$2.2 billion), the ideas of TAIF apparently looked even more attractive. Anyway, according to Albert Shigabutdinov, Director General of TAIF, it was suggested that the company should buy the government equity stake of Nizhnekamskneftekhim (included in the authorized capital of the state holding Svyazinvestneftekhim) provided that by 2009 the annual receipts of the enterprise reach \$3 billion.

However, TAIF, which has lately born huge financial expenses, preferred the trust management variant. In this case this option is suitable, for TAIF is not planning to invest in the petrochemical enterprise: Nizhnekamskneftekhim has enough opportunities to raise financial resources.

«Our goal is to increase the production efficiency due to proper management and appropriate investment program. We know how to do that», said Shigabutdinov to «Neft i Kapital». At the same time he highly appraised the current top management of Nizhnekamskneftekhim, including its Director General, Vladimir Busygin, and declared that he was not planning to make any changes in the management staff.

In the middle of November Svyazinvestneftekhim and TAIF-Invest LLC signed a contract on trust management of 28.61% of the Nizhnekamskneftekhim shares. In compliance with the Russian laws, it will be effective after approval by FAS, which TAIF is expecting to get in December.

At the same time it can be expected that TAIF will retain the right for repurchase of shares after the achievement of the set goal, and TAIF may use this right.

Shigabutdinov insists that the integration under the single management of the major divisions of the petrochemical industry in the Republic is the only possibility for complex and rational management of raw materials and funds of the petrochemical sector for the benefit of Tatarstan enterprises, as well as the only option to avoid the establishment of excessive production and unnecessary competition. «Competition should be not inside the Republic, but in the external markets», he believes. According to TAIF expectations, the realization of these plans will increase the profitability of the sector as a whole at least by 2.5-3 times in comparison with 2002 – at least \$8 billion per year.

Will it be a Vertically Integrated oil company (VINK)?

Some experts in Tatarstan believe that after TAIF gets control over Nizhnekamskneftekhim, the same will happen to Tatneft. «It is obvious that a national vertically integrated oil company is being established and inclusion of an oil-producing company in it seems a logical step, for even today Tatneft is considerably dependant on TAIF not only through the Oil Refinery, but also through Nizhnekamskshina. Actually a major project is being implemented now, which failed earlier in the mid 90-s when other Russian vertically integrated oil companies were being established. Only at that time Tatneft was considered as an integration centre, and now TAIF took its place», told one of the local experts to «Neft i Kapital».

Albert Shigabutdinov does not conceal the fact that the government suggested that they should consider the establishment of the oil-producing structure in the Republic. Anyway, he did not get any «particular suggestions». At the same time he denies that placing Tatneft under control of TAIF

is possible according to the Nizhnekamsk scheme. «In case such a proposal comes in, we will consider it», says Director General of TAIF. «But if there is a possibility to refuse, we will do that».

Currently TAIF is more interested in the establishment of an oil-extraction branch by acquiring shares in small oil companies, which have licenses for exploration and the development of fields ready for commercial operation and having professional staff, primarily in Tatarstan, where there are presently over 30 independent mineral developers with the total output of 5.2 tons per year in 2005. But going outside the Republic is also possible – to Siberia and northern regions. «We are planning to enter these companies with a share equal to their investments in the fields starting with expenses on exploration. The attraction of TAIF as a partner is increased because of the existence of its own oil-refining facilities, so I think our plans are realistic», declared Shigabutdinov.

It should be noted that TAIF has already started its own oil extraction in Tatarstan: it controls a small oil company MNKT, which two years ago acquired «Druzhba» company. MNKT is developing the Aktanysh oil field with the output of about 7 mln tons per year and has the license for geological study, exploration and the development of Akbyazov area in the north of Tatarstan. Druzhba is developing the Nurkeev oil field with the output of about 2 mln tons per year. The total output of these two companies in 2005 shall comprise 200 thousand tons of oil. Starting from here it is hard to establish a vertically integrated oil company, but it is possible as the experience of RussNeft shows (see, «Little by Little» in «N&K», no. 5. 2005). What is required for this purpose is money, administrative resources in the regions and time. Of course, one could bring all small oil com-

panies of Tatarstan into a holding controlled by TAIF, but this is not likely to happen for the President of Tatarstan Mintimer Shaimiev was a guarantor of their establishment as he promised support to small companies in the oil industry. There is another detail – most small companies are more or less controlled by the representatives of the republic and the local elite.

With Tatneft it is much easier and more reliable. It is obvious that the important decision on the state shares of the company (35.9%) will be taken by their owner – the Government of the Republic. To provide the support necessary for this transaction a few votes of the companies on friendly terms with the government of the RT will suffice (for instance, TAIF has 6.6% of votes). One should think that there will be no problems. For example, the sale transaction of the assets belonging to the company Nizhnekamsk NPZ, was approved without any delays, after which Tatneft was no longer a fully vertically integrated oil company. The shareholders may be satisfied with the guarantees provided by TAIF to increase the amount of dividends through increase of the company's efficiency. According to Shigabutdinov, TAIF would first deal with the problem of heavy sour oil «not to be its hostages any more». «We are ready to suggest our solutions and realize them», he told to «N&K», but refused to discuss this problem in details.

If the Tatarstan government includes Tatneft in the structure of the vertically integrated oil company TAIF, we could say that the restructuring of the petrochemical industry of Tatarstan has been basically finished.

Own gasoline

TAIF is planning to celebrate its gaining of control over Nizhnekamskneftekhim. At the end of December the first Tatarstan plant of auto-petrol was put into pilot

industrial operation on its territory. The estimated capacity (in terms of raw materials) of its first turn in the first half of 2006 shall comprise 850 thousand tons of vacuum gas oil per year. The output will comprise 600 thousand tons of various types of commercial gasoline (Ai-92, Ai-95, Ai-98, cut cracking gasoline 80th), the quality of which complies with Euro-2 standard, and up to 100 thousand tons of raw material for rubber production of Nizhnekamskneftekhim (butane-butylene and propane-propylene fractions).

At the same time the potential opportunities of this production will allow the increase of the output capacity up to 1.4 mln tons of gas oil per year, up to 1 mln tons of gas and up to 200 thousand tons of raw materials for the rubber production.

The technologies of the Moscow oil VNII provides for the maximum flexibility of production so it can quickly react to the market demands.

The cost of the project is about \$128 mln. The credit line was opened by Sberbank in September 2003 for 7 years.

This is quite a low-cost project for such a type of construction. The catalytic cracking installation was built not on a new ground but on the basis of the technological equipment no longer in exploitation, with the use of Nizhnekamskneftekhim developed infrastructure. A new construction would have cost at least \$380 mln.

According to predictions, the annual receipts from the use of the installation shall comprise about \$600 mln with the minimum profit of \$60 mln. The payback period of the project is no more than two years after being put into operation.

The problem of the raw material supply for this production has been solved in the most efficient way. The vacuum gas oil is supplied from the neighboring Ni-

zhnekamsk NPZ, the capacity of which allows to produce (depending on the quality of the processed oil) from 1.5 mln up to 1.9 mln tons of this product. That is more than enough for the plant.

The close location of the raw materials shall reduce the self-cost of Nizhnekamsk gasoline. Moreover, in case the plant reaches its full capacity (1.4 mln tons of gas-oil per year) it will fully satisfy the demand for gas in Tatarstan. According to TAIF information, currently about 1 mln tons of gasoline and 1.2 mln tons of diesel fuel per year are currently used in the Republic of Tatarstan. Moreover, the problem of supply of high-quality diesel fuel has already been solved by Nizhnekamsk NPZ.

However, there appeared a problem in course of this simple scheme, as it may seem, realization. According to TAIF, it was created by Tatneft. From September 1st, i.e. from the moment when the oil company lost its control over the NPZ, it started to supply not the compounded high-quality oil as before, but only heavy and sour oil. That oil cannot be used for production of vacuum gas-oil suitable for processing at the Nizhnekamsk cut cracking installation. This circumstance made it impossible for that installation to be put into operation in autumn 2005. While at the Oil Refinery oil is being mixed with gas condensate in the proportion 9 to 1, this allows «using the plant in the critical regime». At the same time they are searching for a compromise. Shigabutdinov declared to «N&K» that the problem would soon be solved but refused to explain the way. One can suggest, the oil company will give in under the pressure of the republican government or TAIF will start buying the raw materials at the market, which this company has long aspired to, but the government of the RT did not let it do that. Or the rates of vertical integration in the oil industry of

Tatarstan will be significantly accelerated.

...to the gas station

Of course, after launching the gasoline production there appears a problem of petroleum products marketing.

In November TAIF increased its share in the biggest after Tatneft marketing structure in Tatarstan – Tatnefteproduct (to 36%). Currently Tatnefteproduct owns 21 petroleum storage depots and 140 gas stations, which gives the company (according to its own information) control over 30% of the retail market of oil products of the Republic (the share of Tatneft is about 35%). Traditionally over 50% of fuel for such marketing was provided by Tatneft (see, for example, «Wind of Changes»

in «N&K», No.12, 2003). However, now a major large-scale consumer is more interested in TAIF. The increase of the share of TAIF, which has its own oil-processing plant in the region of Tatnefteproduct activities, was welcomed. Another thing that the management of the marketing company finds attractive is that TAIF is not intending to acquire the shares belonging to the company and its managers (about 26%). TAIF just does not need it. In case TAIF wants to increase its influence in Tatnefteproduct, it can do it using the already existing scheme – through the state shares (34%).

The competition with Tatneft in the market of oil products, according to Shigabutdinov, will be fair, meaning that Tatnefteproduct will not get any privileges from the gas

plant. All consumers will buy the fuel at the market prices. TAIF will support marketing development in a different way – by provision of access to cheap credits through its financial channels.

As far as the price policy is concerned, TAIF has been lobbying the opening of the oil and petrochemical products exchange in Tatarstan. Currently this project is being developed by the Ministry of Economy of the Republic. At the same time the experts of TAIF are working at the «narrowed exchange», where the auction prices on oil products could be set prior to establishment of a full trading post, depending on the number of applications for bulk purchases. «We will try to open the exchange in 2006», said Shigabutdinov.