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Robert Khannanov: «Our gasoline is not going to be cheap»

High prices on gasoline are not only the «achievement» of oil companies, but the state policy as well, says Robert Khannanov, Director General of TAIF-NK. In his interview he told «VESTI» about the problems of the industry, peculiarities of oil refining business and ambitious plans for the enterprise development.

Primary Redistribution

– Last autumn the government of Tatarstan passed a resolution to sell the already built Nizhnekamsk Oil Refinery (NPZ) to TAIF-NK CJSC, though Tatneft had the equity stake of shares. Why did they «mistreat» Tatneft?

– No one can mistreat Tatneft in the Republic of Tatarstan. First, this company gave rise to the Soviet oil-producing industry. Here the Russian oil school with a serous scientific foundation was formed. Second, almost all large oil-producing companies in new Russia were established on the basis of proven territories and active productions of Tatneft. Third, today Tatneft is in charge of black gold extraction, which is the core of the economy and guarantees the stable development of the Republic of Tatarstan. And this is a great responsibility.

Your question is the result of the lack of information about the true state of affairs in the oil-processing sector in Tatarstan (see Reference). The fact is that Nizhnekamsk Oil Refinery OJSC never owned its property, thus it makes no sense to talk about the controlling stake. Moreover, Tatneft still holds the shares. And the property of this legal entity was owned by three major shareholders – Tatneft, Nizhnekamskheftekhim and TAIF and was leased by them to Nizhnekamsk Oil Refinery. TAIF owned the plant itself (not to confuse with the legal entity Nizhnekamsk NPZ OJSC), and Tatneft and Nizhnekamskneftekhim own the additional viscosity breaking, bitumen and intermediate distillates hydrofining complex installations. The plans for the formation of a new authorized capital were never realized for there were actually no proposals. This is one of the reasons.

The second reason is that we built a plant for auto-petrol production. The raw material for it is the vacuum gas oil produced at the vacuum block of our plant, which is being rented by Nizhnekamsk

ROBERT KHANNANOV was born in 1952 in Zainsk village of Zainsk District of the TASSR. He graduated from the Kazan Building and Construction Institute in 1982 and the Academy of National Economy in 1989. He took the position of Chief Engineer and then Head of the specialized building union Tatneftgasstroy. Later on he was the Head of the subsidiary company TAKPO, JSC ART, LLC RASK. A year later he took the position of Deputy Director General in charge of petrochemical production of JSC Tatneft. Since 2002 he has served as the director of the management company Tatneft-Nizhnekamsk – Deputy Director General of Tatneft OJSC in charge of petrochemical production. Since July 2004, he has been the Head of TAIF-NK LLC. He is married and has got two daughters.

NPZ OJSC. It would be illogical, having taken the plant of primary crude oil processing, which forms the basis for the additional built installations, to leave them without work.

We should also bear in mind that the Program for Development of the Petrochemical and Oil-processing Sector up to 2010 was designed in Tatarstan. Within this Program the strategically right resolution was passed – there shall be two oil-processing plants in the Republic, each refining 7 mln tons. In total 30 mln tons of oil is produced in the Republic thus covering only a half of the Tatarstan «black gold».

The idea of the republican government is clear – the more oil is refined within the Republic, the more grows the added value, tax-ratable amount and finally the Russian budget, as well as the Tatarstan one. The Tatarstan economy primarily depends on the petrochemical production within the Republic. The essence of the President's Program is to minimize the dependency in raw materials from other companies upon existence of our own oil and chemical enterprises. Of course, it is necessary to develop our oil-processing sector, to provide raw materials to Nizhnekamskneftekhim and Kazanorgsintez.

– In mass media there was information that the expenses of Tatneft for Nizhnekamsk NPZ comprised 12 billion rubles, although its share upon purchase was appraised at only 9 billion rubles.

– On the whole, 12.6 billion rubles is the contractual price. The actual expenses, as we think, are much lower. Moreover, the bitumen

In 1997, the government of the Republic of Tatarstan supported the proposal of TAIF for large-scale modernization of the oil refinery belonging to the holding and construction of a new plant for heavy oil processing. TAIF started realizing its plans immediately with its own capacity by modernization of the existing plant and construction of additional installations, including bitumen, intermediate distillates hydrofining complex and viscosity breaking. For construction of a new plant for heavy oil processing Nizhnekamsk NPZ OJSC was registered with participation of JSC Tatneft (63% of the shares), JSC Nizhnekamsneftekhim (25%), JSC TAIF (7.5%) and other shareholders. In 2000 with the purpose of acceleration of programs for oil-processing industry development in Tatarstan, the completion of building of additional installations and the new plant was put in charge of Nizhnekamsk NPZ OJSC. The completion of construction of the new oil-refining plant was planned for 2005, but it did not happen. In connection therewith, in summer 2005 the government of the Republic of Tatarstan passed a resolution to put the owner CJSC TAIF-NK in charge of development of the existing plant (with reimbursement of all expenses for construction of additional installations of Tatneft and Nizhnekamskneftekhim) and put Nizhnekamsk NPZ OJSC, a subsidiary company of Tatneft, in charge of construction of a new more powerful plant.

installation has to be built anew. The contractual price is divided like this – 9.2 billion is the property of Tatneft and 3.4 billion – the property of Nizhnekamskneftekhim.

– Sberbank (Savings Bank) has recently opened a credit line for TAIF-NK. How is this money going to be used?

– Sberbank is our strategic partner. As far as I know, the credit limit set by Sberbank for TAIF group of companies is $2 billion. Within this limit credit agreements for CJSC TAIF-NK were signed for $190 million and 4 billion rubles. We started our cooperation with Kazanorgsintez project, thus the credit to CJSC TAIF-NK is already the second step in cooperation of TAIF and Sberbank.

The credit provided by Sberbank to TAIF-NK is a purpose loan. It is intended for purchase from Tatneft and Nizhnekamskneftekhim of the property and additional installations. In compliance with the contracts the property shall be paid for within 18 months, but TAIF management decided to settle the transaction earlier. Last December this process was finished. The money will be used for construction of a new oil-refinery in Nizhnekamsk and we already have legitimate uncharged property in the form of an additionally built oil refinery.

Heavy Oil

– What is more profitable for an oil company today – to export oil or to send it to your enterprise for refining?

– Today we are buying oil from Tatneft at export prices and with advanced payment. Tatneft has no problems with oil transportation for export for we are so close. I believe Tatneft benefits immensely from our cooperation.

– Therefore, after the construction of a new plant by Tatneft you will have no problems with raw materials supply?

– Of course, no. As I have said before, out of 30 mln tons of oil pro-

duced in our Republic we process only about 7 mln. Moreover, Tatneft is not the only supplier of raw materials on the Russian market.

In the Volga region there is another problem – the quality of oil. In Tatarstan oil has been produced for over 60 years. Our oil is heavy (with a big content of sulfur), the extraction of every ton is quite difficult. Sooner or later the question of the oil quality will arise and the management of Tatneft and Bashneft will have to consider the solutions to this problem.

– Will Transneft close the access to the pipeline for heavy oil?

– It won't, of course. But the companies producing light oil, which has a higher price, have the right to demand its real price for its sale. Why should they be losing money because their oil mixes in the pipe line with heavy oil so that the price of the so-called Urals trademark is lower on the world market?

To compensate the deterioration of the oil quality some additional payments or coefficients will have to be introduced. Each enterprise will have to decide whether it is better to refine heavy oil at its own refinery, get high-quality oil products and sell them at a higher price in Russia or abroad. All this will result in a higher economic effect.

– Which of your products is the most profitable?

– Since December 2005 it is vacuum gas oil. The production of auto-petrol on its base is the most efficient part in oil refining. However this product is quite heavy, close to black oil fuel in all its parameters, and also unfortunately it is liable to price fluctuations. The rates sometimes fluctuate significantly. But the production of auto-petrol 80, 92 and 95 (octane number) is a totally different story.

– Can you give any figures?

– We can talk about the efficiency of oil refining. We have the data of the first two months. At the same time we are buying oil at its export prices and the products of the auto-petrol plant have not yet entered the market, the losses are not significant. That answers the question whether oil refining is profitable or not. And these are only the first steps…

– What quality gasoline are you going to produce?

– So far commercial gasoline Euro 2, which outside Russia can be sold only in the CIS countries. But our first goal is to provide gasoline to Tatarstan. The volume of our production is 80-85% of the demand in the Republic.

– And how are you planning to organize the marketing system?

– In Tatarstan there are two main retail sellers – Tatneft and Tatnefteproduct with their networks of gas stations. Currently TAIF is holding 36% of the shares of Tatnefteproduct, thus we are planning to sell gasoline through its retail network. Tatneft is also willing to establish long-term cooperation with us.

– Is Tatneft going to sell your gasoline only in the Tatarstan market?

– No, in other regions where it has its gas stations as well.

– How would you evaluate the quality of your gasoline?

– Our product complies with the State Standard requirements and we are striving for even more. Within two years we are planning to increase the production of commercial gasoline up to 1 mln. tons a year and gradually reach the quality of Euro-3 and Euro-4.

The increase of our efficiency is just one trend of our activities. The second is bitumen production. We have acquired equipment for road asphalt production. For a long time it was not working but in spring 2007 we are starting the production of road asphalt by oxidation method. In connection with the road building development this is a product in demand both within and outside Tatarstan.

Moreover, by September we are planning to produce aircraft fuel TS-1 or its analogue JET-1 using the western certificates – for foreign airlines. The production of these two products will surely increase the efficiency of our oil-refining plant.

«The lower price on oil would have brought more profit»

– Today the prices on both auto-petrol and auto-kerosene in Russia are higher than in the rest of the world…

– Working in the sphere of production and commerce I know that the price is based on supply and demand and is not set by an individual, like me for example or even a company, say TAIF-NK. That is the reason I cannot say that we are going to produce cheaper gasoline and sell it, say, 30% cheaper. The price is set by the market conditions. Let's take, for example, black oil fuel. In September 2005 the market price of it was 5 thousand rubles for a ton, but in November it fell down to 3 thousand rubles.

– But being a market participant, you also in some way participate in price formation…

– We could talk about the market, prices on oil and other products for a long time. When I was a student the prices on cigarettes and spirits increased drastically. The first reaction was – we need to stop smoking and drinking! But the shock passed. We did not stop drinking and smoking but just considered our profit and prices on cigarettes and found out what we could afford.

– Yes, now you can buy cigarettes for 7 or 70 rubles, but there is no choice when we are talking about gasoline.

– Let's consider this issue. What is the limit of price growth? Maybe someone today can answer the question what the limit of price growth on gasoline or bread? This all depends on the welfare of the most part of citizens. If consumers stop buying petrol the producers will realize that the price is too high.

– Ok, an individual can start using public transport, but what about agricultural companies?

– One can use alternative types of fuel. Gas, for example, is twice cheaper. One liter of condensed gas has the same mileage as one liter of petrol. For many state enterprises this is the current solution of the problem.

– Can the government take measures for reducing the price for gasoline?

– It should start with the extraction of the hydrocarbon raw materials. Not a long time ago I occupied the position of Deputy Director General of Tatneft and I know what the situation is. The taxes on oil are huge! And the price formation starts here. The government shall have to decide how to take money and profits from oil-producing companies – through excises or through direct fixed taxes, or find another form of transfer of income. These are all government policy questions. Tatneft and Bashneft many times submitted suggestions on differentiated approach. At Tatneft, for example, water cuttings of well production reach 80%, the conditions of extraction are much more difficult, and therefore this tax shall be lower. In the present situation none of the oil-producing companies can have a high efficiency.

How is the gasoline price established? Is the high price only due to oil-producing companies or does the state police also have something to do with that? Why is such a huge stabilization fund required? We have artificially created super profits, collected the money and do not know how to use it now. Even people do not keep so much

money in sacks at home, but the money for the stabilization funds has been taken from enterprises, mostly from oil-producing companies. We could continue to impose more taxes on these companies, but in the long run it will result in a high price on gasoline and therefore on everything else – all foodstuffs will be more expensive. Now it's cheaper to fly with foreign airlines than with Russian.

I do not agree with the statement that oil companies are getting too high profits. The lower price on oil would bring them more profits.

– What could you do to reduce the prime cost of your products, if that is possible at all?

– We could do that through production of new products, which are highly in demand, like bitumen and aircraft fuel, and through stable use of all our production facilities. Due to a number of reasons our work has not been stable within the first few months. Our engineering and technical staff has things to work on, the degree of processing and light oil output, for example. We have a lot to do to reduce expenses and increase the plant's efficiency.

– How urgent is the reduction of prices on electricity and thermal energy?

84% of our production cost accounts for oil, raw materials. As for energy supplies, they account for only 1.4%. The most important thing for oil processing companies is the cost of raw materials.

Moscow burden

– What is the average salary at Nizhnekamsk NPZ?

It's about 20 thousand rubles, one of the highest in the Republic.

– What is the number of the staff?

The current number is 1.8 thousand people. When all the divisions are brought into operation the number will comprise 2.5 thousand. Our company is quite compact but at the same time highly efficient and has a high volume of commercial output. In 2006 the output is planned at 75 billion rubles. In two months we produced gas and oil products in the amount comprising 30% of Tatneft output. This monthly figure is 30% higher than that of Nizhnekamskheftekhim and four times higher than that of Kazanorgsintez. This year our commercial output will be twice lower than that of Tatneft, but two times higher than that of Nizhnekamskheftekhim and six times higher than that of Kazanorgsintez.

– Who is the main consumer of your products?

– Our main purpose is to provide raw materials for pyrolysis to Nizhnekamskneftekhim. On the one hand, this coincides with the presidential program on development of the petrochemical sector in Tatarstan. On the other hand, TAIF holds the equity stake of shares of Kazanorgsintez and Nizhnekamskneftekhim and shall provide raw materials to these enterprises.

The cherished dream of the government of the Republic and management of Nizhnekamskneftekhim is not to worry about the supply of one-run gas. It will be realized in April this year, when a plant for gas condensate processing will be put into operation. Having provided one-run gas to Nizhnekamskneftekhim we will be able to increase ethylene supply to Kazanorgsintez. Nizhnekamskneftekhim will have two new types of products – butane-butylene and propane-propylene fractions.

– What tax out of the current Russian taxes do you consider the most «harmful»?

– The most incomprehensive tax for us is the value-added tax. First, the tax itself is not effective, and second, the method of its calculation for all enterprises is not quite correct. For oil-producing companies this is the tax on mining operations.

– Currently the VAT abolishment and introduction of the sales tax is being discussed. Do you think it is an effective step?

– Here we have to bear in mind that any good idea in the process of its realization may be distorted. But at the same time, the tax burden on enterprises shall surely be reduced. Do you remember how many discussions there were around the 13 per cent income tax? As a result, the government did not lose. The same equates with companies. For instance, just recently up to 50% of the profit could be used for the company development, thus reducing the taxable base up to 50%. The cancellation of this provision does not seem right to me.

The wish of the Ministry of Finance to collect as many taxes as possible is clear, but at the same time there should be created conditions upon which the reduced receipts today may lead to increases up to two, three times in the future.

TAIF-NK CJSC (subsidiary company of TAIF Public Corporation) was established in 1997 for construction of the Nizhnekamsk NPZ with the capacity of 7 mln tons per year. In the fall of 2005 TAIF-NK bought from JSC Tatneft and Nizhnekamsneftekhim OJSC the additional installations built on the territory of the Oil Refinery and is now the owner of the whole oil-refining complex. In December 2005, a new plant for auto-petrol production with the capacity of 600 thousand tons per year was put into operation. In the spring of 2006, a production for gas condensate processing is planned to be launched with the capacity of 1 mln tons per year.