The Moscow Times
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Oil Giant Rosneft Struggles as Western Sanctions Take Toll

By The Moscow Times

September 09, 2014

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The Kremlin's prized oil firm Rosneft is cutting staff and production and selling stakes in Siberian fields in the strongest evidence to date that Western sanctions are hurting what was the world's fastest growing oil firm in recent years.

The sanctions imposed on Russia by the United States and Europe in response to its military action in Ukraine have cut Rosneft's access to Western financing and technology, complicating the servicing of its $55 billion debt and closing the way to cutting-edge industrial science it needs to keep developing its energy resources.

Few doubt that Rosneft will be able to withstand the pressure medium-term —its earnings amount to $30 billion a year and billions more are still available via Chinese credit lines and Russian state coffers in case of emergency.

But the world's biggest listed oil producer — which produces more oil than OPEC members Iraq or Iran — faces unprecedented challenges to its long-term expansion and modernization plans.

Last week Rosneft said it would cut staff to reduce costs: Kommersant business daily said Rosneft's Moscow headquarters would see cuts of up to 25 percent from the current 4,000.

These would be the first significant job losses at a company that swelled via the acquisition of rivals such as Yukos, pushed into bankruptcy some ten years ago by the government of President Vladimir Putin.

Since then Rosneft's output has risen 10-fold to exceed 4 million barrels per day or four percent of global supply. But last week it reported a 1.3 percent production drop in August, as production in West Siberia regions declines.

The firm, which alongside gas monopoly Gazprom is a top contributor to the Russian budget, needs to invest heavily to bring new east Siberian fields online — a costly endeavor now made more difficult by the sanctions squeeze.

In a sign of the challenge such a project now presents, Putin said last week Rosneft would welcome China buying a stake in the prized Siberian Vankor field. It was a major about-turn given the Kremlin's long resistance to allowing its powerful neighbor access to such deposits.

"Rosneft's decision to offer China a stake in the mega Vankor oil field in East Siberia signals that Moscow's bargaining position has been further weakened by sanctions and that it needs the capital infusion," said Emily Stromquist, analyst at Eurasia.

"Credit Stopped"

Rosneft needs to invest more than $21 billion annually until 2017 to launch new fields and upgrade refineries.

It also needs to repay $12 billion by year-end and another $17 billion next year, after it borrowed heavily to buy rival TNK-BP for $55 billion last year — a deal that included BP taking a 20 percent stake in Rosneft.

Rosneft should be able to access some of the money it needs from short-term credit lines via Western banks as the United States sanctions only prohibits them from providing loans with maturity longer than 90 days.

But with the European Union expected to impose similar lending bans soon, Rosneft boss Igor Sechin under personal sanctions owing to his closeness to Putin and any resolution to the Ukraine crisis a long way off, all Western lending to Rosneft has in fact stopped, finance and industry insiders say.

"The credit has stopped. All conversation has become purely theoretical. People fear everything is following the patterns of the Iranian (sanctions) scenario when credit and then oil flows were getting progressively hurt," said an executive with a Western trading house and a major buyer of oil from Rosneft.

Over the past year, BP and trading houses Vitol, Glencore and Trafigura provided Rosneft with $20 billion worth of loans syndicated by banks and guaranteed by oil exports.

But Rosneft's attempts to borrow more from them in recent months have stalled or been drastically curtailed because the banks refused to syndicate new deals.

Rosneft CEO Sechin was forced to ask for $40 billion in state help from one of Russia's sovereign wealth funds and Prime Minister Dmitry Medvedev said the company could get it.

"The company needs to maintain its production levels, because Rosneft is a major source of tax revenue," Medvedev told Vedomosti business daily on Monday. "As such, we should help it maintain its level of investment."

A Rosneft source said the company had no plans to borrow for the next 12-18 months and that credit lines offered by China's state oil firm CNPC meant the company had enough liquidity to see it through.

"We are planning to cut debt further without reducing capex. We need to maintain huge investments to launch new East Siberian fields. After 2017 capex will drop," the source said.

Money but no Know-How

Though the Russian state and Chinese allies may keep money flowing to Rosneft, they cannot supply vital technology.

Rosneft said last week it planned to replace all equipment and technology imports from the West as the U.S. and EU sanctions halted all trade with the firms upon which it usually relies for such essentials.

In the meantime however it will struggle to find what it needs to develop shale and deep water Arctic oil because Russia has made little progress in building its own services sector.

Just last May, Energy Minister Alexander Novak asked Putin to boost funding of domestic equipment producers because a quarter of all equipment used in oil output enhancement was imported.

Russia is particularly dependent on the West for catalysts, refining equipment and gas turbine parts, meaning complicated refinery modernization works are seen almost impossible to achieve without the access to Western know-how.

Rosneft plans to launch 10 new fields by 2020 in a bid to increase its combined oil and gas output by a third to 6.4 million barrels of oil equivalent per day. That plan looks set to be severely tested.

"Rosneft has a lot of cash. Its problems are long-term and strategic," said a source at a Western bank that includes Rosneft among its clients. "Its growth model is challenged."

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