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## Rosneft: Welcome to Vankor!

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**We visited Rosneft's huge greenfield project – the Vankor oilfield, in the northern part of Krasnoyarsk Region (Eastern Siberia). The trip included a presentation of the company's drilling support center in Moscow, a visit to the site in Siberia, and a meeting with Vankorneft management to discuss operating development of the field. We are now more confident about Vankor production targets due to high flow rates at wells and higher-than-expected overall production. Other Rosneft fields close to Vankor will further expand East Siberian output. However, latest signs are that the tax regime will be less favorable than hoped. We therefore confirm our HOLD recommendation for Rosneft stocks.**

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We visited the Vankor field, Rosneft's large new production asset located in the northern part of Eastern Siberia, beyond the Arctic Circle (see map below). Vankor ABC1+C2 reserves are about 522mt of oil and 132bcm of natural gas (some 10% and 4% of total Rosneft oil and gas reserves, respectively).

Vankor was launched in mid-August 2009 and crude output from the start exceeded 5mt (3.5mt in 2009). Rosneft plans to produce 12.5mt in the whole of 2010, increasing to 17mt in 2011 and to a 5-7 year peak of 25.5mt in a few years' time. We now see the goals as achievable, since current daily well flows are about 400-450 tonnes, which is significantly higher than both market and Rosneft benchmarks (roughly 100 and 150 tonnes, respectively, based on our estimates).

Average daily output per well at Vankor is now 35 300 tonnes, which is 41% higher than the 2010 plan. The company says that the results have been achieved thanks to large share of horizontally drilled wells, which significantly increase flows.

Lack of established oil & gas transportation infrastructure, severe climate (temperatures range from -60°C to +30°C), and environmental considerations made Rosneft use innovative technologies and services of top-ranked companies such as Schlumberger and Halliburton as well as domestic leaders, Eurasia Drilling Company and Integra. These investments have already improved the oil recovery ratio to 0.43x vs. Russian average 0.35x, reduce geological risks by 30-40% (company estimate) and reduce the number of wells by three times in comparison with "standard" oilfield development methods.

Rosneft will utilize more than 95% of associated gas by 2012, using it at Vankor's gas turbine power station and supplying of least 5bcm annually to the market. Gas will be delivered through a gas pipeline at the Nakhodkinskoye oilfield, owned by Lukoil.

More upstream potential is offered by nine other Rosneft oilfields close to Vankor (see map below) with estimated prospective resources of some 371mt of crude oil and 288bcm of natural gas. Rosneft started exploration works at these fields in 2006 (6 wells were drilled by 2010) and plans to drill 4 more wells this year. New reserves of the smaller fields will support and expand the plateau level at Vankor.

Largest of the adjacent areas are Baykalovskiy (300km north of Vankor) and Lodochniy (south of Vankor) blocks. Rosneft drilled one well in 2009 at Baykalovskiy and discovered about 53.1mt of crude oil and 28.2bcm of natural gas (C1+C2 reserves). Reserves at the Lodochniy block are expected to be about 43.2mt of oil and 69.8bcm of gas, but exploration work has not yet started at this field and potential may increase in the future.

On the downside, Rosneft capability to invest in the new upstream assets could be restricted by the tax regime. The Minister of Finance, Alexey Kudrin, recently proposed canceling planned zero export duties for crude from 22 new Eastern Siberian oilfields (including Vankor) to help compensate the budget deficit in 2010. Media later reported that zero taxes will go ahead in 2010, but export taxation will be at a "privileged" (non-zero) rate in 2011-12 and the privileges will be canceled thereafter.

Rosneft management confirmed Finance Ministry opposition to zero export tariffs, but noted that the Russian government wants to at least keep oil production levels in Russia flat, which cannot be done without large investments in new upstream capacities. A final decision on tax policy for East Siberian fields has not yet been made. Rosneft is the biggest winner or loser among Russian VICs from tax decisions on fields in Eastern Siberia.

We confirm our target price of \$8.90 per share and reiterate a HOLD recommendation for Rosneft stocks. We still see the company as overvalued in comparison with main peer, Lukoil, and uncertainties about the tax regime for Vankor and other company fields in East Siberia are additional negative factors.

**Vankor location**



Source: Company data

**Potential synergy with nine closest Rosneft fields**



Source: Company data

Photo report of the trip



*Igarka, the closest town to Vankor*



*Vankor located within the Polar circle in fenland*



*Existing wells and drilling of a new one*



*Oil treatment and water discharge facility "South"*



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