

**M&A NEWS****Shtokman update**

Barents Sea offshore gas project with estimated reserves of more than 3.7 trillion cubic meters of gas and ca. 31 million tons of condensate. First phase project investments amount to US\$ 10 billion, annual gas production is envisaged at 22.5 billion cubic meters, the project also involves construction of an LNG plant with 15 million tons capacity, total project development costs according to different estimates are between US\$ 40-50 billion.



In October 2006 Gazprom's management quite surprisingly decided to proceed with the Shtokman project on its own without attracting foreign investors. For a long period of time Gazprom considered giving 49% in the project to foreign strategic partners. Among short-listed candidates were Norwegian Hydro and Statoil, French Total and American ChevronTexaco and ConocoPhillips. Gazprom also announced a "priority change" in Shtokman gas deliveries: now it is planned to transport bulk gas trade volumes via the Nord Stream pipeline to Europe, instead of using gas tanker deliveries to the US. Later in October, Gazprom announced that it will delay LNG plant construction for two years and will not launch it until at least 2013. According to Gazprom's investment

**M&A in the Russian oil and gas industry**

The following article is an excerpt from the M&A Guide for the Russian oil and gas industry published by ACP and the law firm Nörr Stiefenhofer Lutz in September 2006.

**Investment structures****1. Sale of hydrocarbon assets**

There are typically two ways of acquiring a company: either by way of an asset deal (or by way of a share deal. The most important asset held by an oil and gas company is its subsoil use rights. Whereas it is in principle possible to acquire the transferable assets owned by an oil and gas company (e.g. its equipment items) special rules apply to subsoil use rights.

The sale of hydrocarbon reserves contained in the subsoil by way of direct sales of subsoil use rights under a **licence** is in principle not possible under Russian law. Licences are issued to companies and can only in exceptional cases be transferred to other companies. They would terminate upon transfer outside one of the permitted situations.

It would be possible to sell subsoil use rights under a **production sharing agreement** (subject to the State's approval).

Please note that the Draft Subsoil Law provides that subsoil use rights acquired on the basis of the specially **regulated contracts** can be transferred, subject to consent of the relevant State authorities. The purchase of subsoil use rights under a regulated contract may be an attractive option to an investor who feels uneasy about the financial position of the company holding the rights.

**2. Sale of shares****2.1. Companies under Russian law and types of shares**

Russian law provides two forms of companies,<sup>1</sup> the limited liability company (LLC) and the joint stock company (JSC). Joint stock companies can be established as closed JSC (ZAO, limited to a maximum of 50 shareholders) or open JSC (OAO, permits an unlimited number of shareholders).

Complex share structures are often ill-advised in Russia and

<sup>1</sup> The term 'company' is more narrowly defined than the term 'legal entity'; the latter comprises both partnerships and companies under Russian law.

programme for 2007, the company plans to spend RUR 17.1 billion (ca. US\$ 650 million) on the Shtokman project. In our view, sooner or later Gazprom will need foreign investment in the project, as it is very risky to develop the project without partners. Further development of the project will depend mainly on political dialogue between Kremlin and the parties involved.

31 October 2006

### **Lukoil is looking to acquire 300,000 bbl/day European refining capacity**

Russian oil company Lukoil wants to buy up to 300,000 bbl/day in refining capacity in Europe, the company's CEO said, according to Reuters.

The company is looking at several refining and retail assets in Europe, CEO Vagit Alekperov reportedly said.

The company won a tender for Kuwait Petroleum's 85,000 bbl/day Europoort refinery in the Netherlands, which may be sold for as much as US\$1 billion. However, later the Kuwait company decided not to sell the refinery.

Lukoil is expected to attempt buying Chevron's gasoline station network in the Netherlands, Belgium and Luxembourg.

The company also plans to spend US\$ 1.8 billion on refinery investments until 2014.

25 October 2006

### **TNK-BP acquired 3 licenses in Taimyr**

TNK-BP won auctions for three oil and gas licenses in the Taimyr region of Krasnoyarsk with combined geological resources of 54 billion cubic meters of gas and 63 million tons (460 million bbl) of crude oil under C3+D1 classification. The licenses are for 25 years, including a 5 years exploration

are limited by the simple fact that a JSC is only permitted by law to issue two types of shares: ordinary shares and preference shares, the respective rights of which are broadly defined by law. The main difference between the two is the voting rights. Preference shareholders may vote only in very limited cases, such as on a company's reorganisation or liquidation. Investors considering using preference shares as a mechanism for redistributing equity should be aware of their potential downside. In Russia, there is a risk in issuing preference shares to an incoming investor, because on failure to pay a dividend the preference shares automatically become voting shares which could upset the previously agreed balance of control. It should also be noted that the total nominal value of all issued preference shares may not exceed 25% of the company's total charter capital; all newly issued shares must be fully paid for at the time of acquisition (a foreign investor may not pay in foreign currency for the shares acquired).

## **2.2 Direct acquisition**

### **2.2.1 Purchase of shares in a Russian company**

A purchaser sometimes acquires directly the shares in a Russian company which holds the subsoil use rights to the exploration and production of the hydrocarbon resource. This Russian target company may itself be the operator of the exploration and exploitation activities. However, in many cases the operation is done by a separate company. The purchaser will have to decide whether or not he also wants to acquire shares in the operating company (which may sometimes be the case but not always) or will simply rely on an operations and maintenance (or service) agreement with the operating company.

The acquisition of shares in the target company may be preceded by a share capital increase in the target company if the seller only wants to divest part of its shares and its main goal is to pursue a joint investment strategy with a partner on the basis of increased equity.

### **2.2.2 Acquisition of shares in an offshore company**

Many Russian companies holding hydrocarbon licences are held by separate holding companies (so-called special purpose vehicles). Often an acquirer just purchases shares in this holding company. In the past many holding companies used to be located in Cyprus. With Cyprus'

period. The company paid RUR 879 million (US\$ 33 million) for the three licenses with total resources of 810 million barrel of oil equivalent (US\$ 0.04 / boe).

24 October 2006

### Star Energy acquired Volga-Neft

Star Energy Corporation, an independent oil and gas producer in Texas, USA acquired a small Russian upstream company Volga-Neft which holds a production license for the Rodnikovskoye oil field in the Orenburg region of Russia.

Under the terms of the purchase, Star Energy acquired 100% of Volga-Neft in exchange for 10,000,000 newly issued, restricted shares of Star Energy (26.1% of the charter capital).

The estimated recoverable resources of the Rodnikovskoye oil field are 12.9 million tons (95 million bbl) of crude oil.

Star Energy is said to have paid ca. US\$ 2 for the barrel of recoverable resources. We believe the price is a market price for mid-sized oil fields in Russia.

10 October 2006

## FINANCIAL ADVISORY NEWS

### VTB floats US\$ 1.75 billion of 2-year Eurobonds

Russian state-controlled foreign trade bank Vneshtorgbank (VTB) placed two-year Eurobonds in an amount of US\$ 1.75 billion at LIBOR + 0.6%, *fcnews* reported. The bonds are to be redeemed in August 2008. Barclays, Deutsche Bank and JP Morgan arranged the placement. VTB is Russia's second largest bank by assets after Russian state-owned savings bank Sberbank. VTB's authorized capital is RUR 52.11 billion (US\$ 1.95 billion). The government controls 99.9% of VTB shares. Today, VTB Group comprises three Russian banks, seven banks in

accession to the European Union it is to be expected that in future holding companies will increasingly be found in other offshore jurisdiction (such as the British Virgin Islands).



## 2.3. Indirect acquisition

The purchaser may not wish to be directly liable for the liabilities of either the target company or the holding company. In such cases he will establish a special purpose vehicle for the purposes of the acquisition, usually called "NewCo" in the context of acquisitions. NewCo will be domiciled either in the Russian Federation or an offshore jurisdiction (depending on the tax requirements of the parties) and become the holder of the shares in the target company. NewCo will thus become a holding company. The purchaser's equity contribution will be injected in this special purpose vehicle and potential acquisition debt will also be provided to the special purpose vehicle. In a so-called non-recourse financing the purchaser will not even provide direct guarantees or other financial undertakings for the benefit of the financing banks, in a limited recourse financing the banks will at least have some degree of recourse to the purchaser by way of guarantees or other financial undertakings.

The indirect acquisition route offers another structural advantage: it may allow using the interest payments on the acquisition debt for reducing the amount of taxes payable. This is a critical aspect in many acquisition financings since it may significantly increase the amount which can be debt financed. It is also a more tax efficient way of implementing an acquisition. However, careful structuring will be required to achieve the desired results.

Western Europe, four banks in the CIS, several affiliates in Africa and a joint venture financial company in Namibia.

30 October 2006

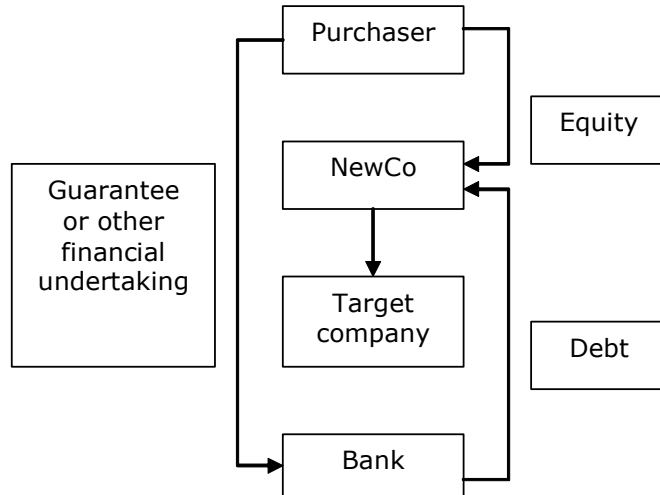
### Rosneft attracted a debt financing of US\$ 24.5bn

Russian oil company Rosneft raised a record US\$ 24.5 billion in bank loans, Bloomberg reported. Earlier various Western news agencies reported about Rosneft plans to raise a large debt facility. According to their information sources, Rosneft signed a mandate letter for debt raising with seven banks - ABN Amro, Barclays, Calyon, Citigroup, Goldman Sachs, JP Morgan and Morgan Stanley. Rosneft will use the new credit facility to participate in the sell off of remaining YUKOS assets. In addition to Rosneft, also Gazpromneft and Lukoil confirmed their interest in the acquisition of YUKOS' assets.

Rosneft is forced to raise the credit facility due to their equity shortage. In July 2006, the company raised over US\$ 10 billion in an IPO, however, most of it was used for debt repayment.

Rosneft is one of the largest oil producing companies in Russia with an estimated market capitalization of approximately US\$ 77-78 billion.

30 October 2006



## 2.4 Farm-in agreement

A farm-in agreement (often referred to as 'farm-out agreement thus reflecting the perspective of the transferring party) is a transfer of a part of the shares in an oil or gas company in consideration for an agreement by the transferee to meet certain expenditures that would otherwise have to be undertaken by the licensee. This is particularly common at the exploration stage. Essentially a farm-in agreement combines any of the above mentioned investment structures with an additional investment commitment. The advantage of a farm-in arrangement for the selling party is that it can keep some interest in the company although it has not sufficient funds for its further development.

### ***In the next issue of the ACP Monitor more on: Swap of shares, greenfield projects, joint ventures and hostile takeovers***

Based on its market knowledge and transactional experience, ACP has developed an M&A Guide for the Russian oil & gas industry in co-operation with the law firm Nörr Stiefenhofer Lutz. RPI, and Statoil ASA and LeBoeuf Lamb were involved in preparing the Guide. The Guide describes in detail legal and tax issues of mergers, divestitures and acquisitions in the Russian oil & gas industry, and shall be of assistance to companies and individual investors interested in acquiring or divesting Russian oil or gas assets with a focus on the upstream sector. The Guide is provided to our clients free of charge upon request.

**MARKET DATA****Acquisition multiples in Russia**

Date	Buyer	Acquired oil fields / companies	Reserves classification	Oil reserves (m ton)	Acquisition price (US\$ m)	EV/resources (US\$/bbl)	Region
10/2006	Luidor	Nitchemju-Sininskoye	C3	1.9	0.2	0.02	Komi region
10/2006	Gazprom	Povarnitskaya area	D1	4.4	14.2	0.44	Komi region
10/2006	Devon	Savinoborskaya	C3	0.3	2.5	1.33	Komi region
10/2006	Devon	Savinoborskaya	D1	12.5	2.5	0.03	Komi region
10/2006	Devon	Savinoborskaya	C3+D1	12.8	2.5	0.03	Komi region
10/2006	Star Energy	Volganefit	C3+D1	13.0	11.7	0.12	Orenburg region
10/2006	TNK-BP	3 licenses in Taimyr	C3+D1	111.0	33.0	0.04	Taimir region
09/2006	Rosneft	Kulindinskiy	D1	200.0	55.7	0.04	Krasnoyarsk region
08/2006	Rosneft	Lulindinskiy	D1	200.0	55.7	0.04	Krasnoyarsk region
08/2006	Gazprom	Taterskiy	D1	150.0	5.6	0.01	Krasnoyarsk region
<b>Average for resources:</b>						<b>0.21</b>	

Source: ACP research

**Selected debt transactions in Russia**

Date	Borrower	Currency	Facility size (m)	Tenor (months)	Interest rate (% p.a.)	Arrangers
10/2006	Sberbank	US\$	1.500	36	L+0.3	ABN AMRO Bank, Barclays Capital, JP Morgan, Sumitomo Mitsui Banking Corporation Europe
10/2006	Itera	US\$	450	39	8	VneshEconombank
09/2006	Rusal	US\$	2.600	60 84	1 <sup>st</sup> tranche: L+1.10 2 <sup>nd</sup> tranche: L+1.40	ABN AMRO, BNP Paribas (Suisse), Calyon, Citigroup
07/2006	MTS	US\$	630 700	36 60	L+0.8 L+1 (1-36 months) and L+1.15 (37-60 months)	Bank of Tokyo-Mitsubishi, Bayerische Landesbank, HSBC, ING, Raiffeisen Zentralbank Oesterreich (RZB), Sumitomo Mitsui Banking Corporation Europe (SMBC)
04/2006	Gazprom	US\$	1.526	48	L+0.55	ABN AMRO, Calyon

Source: ACP research

**Asset Capital Partners** is an international investment banking and financial advisory firm based in Munich and Moscow with a special focus on Russia and other CIS countries.

**Asset Capital Partners GmbH**

Prechistensky per. 14/1  
119034 Moscow, Russia  
p: +7 495 981 0791  
f: +7 495 981 0792

[moscow@assetcapitalpartners.com](mailto:moscow@assetcapitalpartners.com)

[www.assetcapitalpartners.com](http://www.assetcapitalpartners.com)

**Asset Capital Partners GmbH**

Bauerstrasse 20  
80796 Munich, Germany  
p: +49 89 242 246 910  
f: +49 89 242 246 990

[munich@assetcapitalpartners.com](mailto:munich@assetcapitalpartners.com)

[www.assetcapitalpartners.com](http://www.assetcapitalpartners.com)

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