

Gazprom conquering SEE markets from Serbia base, Interview of NIS CEO Kirill Kravchenko

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The last year was the most successful ever since NIS was established. What are the reasons, in your opinion, which allowed you to achieve this result?

NIS j.s.c performance in 2012 practically and completely met our expectations under the business plan. First of all, we met the crucial promise we made in 2009 when we acquired the control stock in NIS – on November 1, we commissioned the MHC/DHT unit in Pancevo Refinery, i.e. the first stage of modernization of the Company's refining capacities funded by the NIS j.s.c. majority shareholder, the company Gazprom Neft, was completed. Gazprom Neft had allocated more than EUR 500 million such purposes. The second important result last year was the expansion of NIS business operations outside the Serbian borders – our petrol stations in Bosnia and Herzegovina, Bulgaria, and Romania started with operation, while geological explorations were initiated within foreign exploitation projects. And finally, the third and very important thing for the regional market was the opening of first petrol stations with the new premium brand – «Gazprom», the management of which had been entrusted to our company in all countries of South-East Europe.

Still, the most important thing in 2012 for us was our focusing on the technical and technological development of the company – during the whole year we actively purchased new equipment, introduced new technologies in all areas of NIS business operations – from the area of production and refining to the area of human resources. Therefore, our investment program broke all records again – we invested RSD 50.8bln in the company development in 2012, which was more than ever in the last few decades. The second factor, without any doubt, were the people – the international team of managers who had become well coordinated during the previous years, whose efficiency was enhanced by new players and who achieved the business plan and the objective set to NIS by the Company's shareholders. We invested lots of efforts there as well – during the whole year, ISO and SAP



standards were being introduced in the Company, therefore, it's no wonder that, in our partners' opinion, we take the position of the regional leader in that segment. During the entire 2012, we actively developed our own human resources – hundreds of NIS employees, from the top management to young coordinators, participated in different training programs. It is important to say that the average age of the Company employees was reduced – in 2009, it was almost the age of 50, and nowadays the average employee age is 42 years, while more than 12% of NIS employees are under 30. Corporate culture was also successfully developed, having had a positive impact on employee motivation and efficiency.

It is indicative that the number of Serbian managers in the NIS top management seriously soared in 2012 – now, the nationals perform the functions of key deputies of the NIS CEO, and are in charge of large projects, strategy and investments and the development of petrochemical business. Apart from that, several Serbian managers will soon assume the positions of NIS regional managers who will be in charge of business operations development in certain countries. Another instrument of professional development will be an extensive human resources rotation with «Gazprom Neft», which was also initiated in 2012 – the first 20 representatives of NIS have already completed their internship in the facilities of our majority shareholder. The lists of «Gazprom Neft» strategic personnel reserves include Serbian surnames for the first time now.

All the efforts we invest in the development of our employees are appreciated by external audience as well, and by its rather different parts – therefore, NIS was assigned the title of the best employer in 2012 by the Serbian Association of Managers, while 25% students saw NIS as the best place to start their professional career. This number is very important if we take into account the fact that it is almost twice as high as the number of students who opted for our main rivals – the Coca-Cola and Telenor.

Another, in my opinion, quite important success factor was the fruitful cooperation between the NIS – «Gazprom Neft» shareholders and the Serbian government. There is an old Serbian saying stating that a house should be constructed from the foundations upwards, and if we paraphrase it, we could say – without good foundations in the form of a stable and positive communication among the shareholders, no success would be possible.

This is exactly the reason why we have been able to endure the pressure of the economic crisis, whose effects were felt during the entire 2012, and once again we showed positive business result trends. The main criterion of the Company's success, net income, has been increased by 22% and it amounts to RSD 49.5 bln. We have the same situation with the EBITDA – this indicator has been increased by 27% to RSD 66.5 bln. We can already say with certainty that, in terms of the 2012 results, we are well ahead of the majority of our rivals, including one of the key regional players – the Croatian INA. All in all, the NIS financial results in 2012 re-confirmed the serious role of our Company in the Serbian national economy – in 2012, we contributed about 8% of the total GDP of the country, which was equivalent to the share of the entire agricultural sector, but having regard that our share has kept growing ever since 2010. Without growth of NIS, the drop in the Serbian GDP might have been twice as high judging by the results achieved in the last year!

What are NIS plans for the retail network? What are your forecasts for the regional positioning of NIS, considering the serious competition in Romania, Bulgaria and

B&H?

In 2012, our key word related to the retail sector was „development“. We were developing our national network in Serbia – about 240 PSs were modernized and re-branded, a new national brand was launched – „NIS-Petrol Tricolor“, which symbolizes the unity of the Serbian and Russian NIS shareholders. Apart from that, our Sales and Distribution started the active operations in the region – in 2012, NIS opened gas stations in Bosnia and Herzegovina, Romania and Bulgaria. We acquired about 100 PSs and locations for new construction works outside the territory of Serbia.

Special attention should be paid to the fact that a new PS premium brand – «Gazprom» was launched both in Serbia and in the region. To put it in a nutshell, we use the fusion of the economic brand

„NIS-Petrol“ and the premium brand „Gazprom“ to cover a more extensive range of customers and expand our distribution channels. All in all, our perspective in terms of the «Gazprom» network is as follows – in the next three years, we intend to create a well-spread premium network in Serbia, Bosnia, Romania, and Bulgaria, which will be able to compete with the best European companies operating in this segment with the quality of its services.

We don't see the competition as a threat, but as a stimulus to increase the quality of our operation – we have a potential to do so, therefore, I have most serious expectations that our networks operating in the neighbouring countries will be positioned high in retailers' list, in the most recent period. Our plans are quite ambitious in this respect – we plan the establishment of an 800-PS network by 2015, and half of these will operate outside the Serbian territory. We also plan to invest about EUR 400 mil. in the Sales and Distribution development by 2015.

In 2012, we extensively modernized the Sales and Distribution logistics – we purchased new tank trucks whose use significantly reduced the risks and losses in the transportation of petroleum products, we started reconstructing oil warehouses, we acquired new warehouses in Bulgaria, we prepare the construction of oil warehouses in Romania. In order to stimulate the sales, we developed and introduced an integrated system of corporate fuel cards, which will help our customers to choose the mode of cooperation with our Company which they find most suitable. The fuel cards may be used both by physical and legal persons, and not only in Serbia, but in other countries where NIS PS operate, as well. We have regular loyalty campaigns for large consumer groups, during which our regular customers can purchase a variety of goods at a certain discount.

Of course, a dynamic growth in this direction is impossible without investments – in 2012, RSD 13.2bln was invested in the development of the NIS retail network, which was almost by 300% more than in the previous year. Our efforts had positive results – despite the fact that fuel consumption in Serbia in 2012 dropped by 9% in comparison to 2011, the NIS share in the market was increased by almost 6%, and the scope of sales of petroleum products offered at our GS was increased in the absolute value, as well – the scope of daily fuel sales at an «average» NIS PS was increased by 38%. All this speaks of one and the same thing – the efforts we have been putting in the development of the retail sector all these years have not remained unnoticed by our customers, and we thank them heartily for it. Thank you for believing to our Serbian NIS! Now, we plan to develop our new premium network brand –

«Gazprom», and this will be our priority in 2013.

“Gazprom“ PS will not compete with “NIS Petrol“ PS?

As I have already said, these two brands have different target groups. The “NIS Petrol“ PSs are intended for an extensive target group, and the most important thing for this group is to buy European-quality fuel at affordable prices. The additional PS services play a secondary role for these customers. At „Gazprom“ PS, the approach is slightly different – there, customers will not only be able to buy top-quality fuel, but also the entire range of services and options – from an exchange office and Internet access to the possibility to have lunch in real restaurants and visit stores with an extensive selection of goods. Therefore, we cannot really speak of the competition between these two brands – they complement each other, but are by no means the rivals. I would like to add that this «double-brand» system has already proven as successful all over the world, and this is exactly the reason why we decided to introduce it to Serbia, as well. I would like to remind you that NIS is not the only one who set off down this road – the same retail practice is implemented by giants like Shell, British Petroleum, OMV. As our research has shown, about 16% drivers is ready to use the services of a premium-class PS, while the economic brand option is attractive for about 49% of drivers, therefore, the double-brand strategy enables us to attract practically two-thirds of fuel consumers to our PS.

We do not hide such data from anybody. Due to the implementation of new technologies in the production of carbon-hydrates, in 2012, we managed to increase the scope of crude oil and gas production in Serbia by 11%, and speaking in absolute numbers, we produced 1693 thousand tons of oil and gas equivalent last year. Our plans for 2013 are not less ambitious – this is the beginning of a commercial exploitation of the deposits in Bosnia, Hungary and Romania, we want to increase the efficiency of production in Serbia, most of all, due to the application of Hi-Tech solutions. I would particularly like to emphasize that we compensate for the growth in the production with a high tempo of growth of proven reserves, and there were none of these in 2009. Only in 2012, the reserves were increased by 12%, and since 2009, the reserves have increased by the total number of more than 20%. Another important moment – the growth in production – is, first of all, the result of our active investments in the development of its efficiency – for example, we invested more than RSD 20 bln in this area in the last three years, and we will invest at least another RSD 40 bln in the years to come. It is enough to say that in 2012, within our technical and technological equipment program, which was funded with about RSD 10 bln, we purchased and modernized four high-efficiency drilling devices, two complexes for well overhaul, and the new 3D seismic exploration equipment was purchased as well. I would also like to draw your attention to the fact that, in 2012, our «brain trust» started its full operation – the NIS Scientific-Technical Centre dedicated mainly to the technological development of production. In these terms, we have a special advantage over our rivals – when it comes to technology, we rely on the resources and support of the entire «Gazprom» group, which considers us to be its regional centre and is prepared to help us as much as possible to increase our efficiency.

As early as in 2012, we started applying small-radius drilling technologies, we are prepared to start implementing horizontal drilling technologies and multistage hydraulic fracturing techniques. In the next year, our priority will be to increase the proven reserves of oil and

gas, plus to increase the production primarily due to efficient exploitation of the existing wells in combination with the active operation in the countries of the Pannonian oil and gas basin.

What are NIS interests in the Energy area?

First of all, the transformation of NIS from a national oil company to a regional energy holding is a part of the strategy for Company development by 2020. Secondly - we haven't thought of anything incredible here, the energy sector became a standard for all large oil companies long time ago, including the ones operating in South-East Europe. Still, from the practical point of view, the intention here is to include energy projects in order to materialize to the maximum all those advantages NIS has from its general business activity. A typical example is a small co-generation project, whose implementation started in 2012. Before, the associated oil gas was simply supposed to be incinerated with a torch at the very well because there were no technical possibilities for its exploitation; now, we started installing co-generation devices at the sites, and they will use the associated gas to produce electricity necessary for the drilling. The benefits of this project are multiple - first, this will increase our energy efficiency, second - well maintenance costs will be reduced, third - infrastructure will be developed.

Another two ambitious projects we plan to implement in 2013 include the reconstruction of Novi Sad TPP-HP and the construction of Pancevo TPP-HP, where we also intend to apply the principle of materialization of our potentials in the gas business segment - the income from the sales of electricity obtained from gas are significantly more stable and predictable.

Another important project, whose implementation started in 2012, is the «Plandiste» wind park, worth of EUR 160 mil, and NIS has 50% of shares in this project. Our interest here is the fact that we will be able to use the electricity obtained from renewable energy sources and help Serbia meet the EU requirements related to the increase of the share of the «green» energy in the total energy consumption, but that we will also resolve the matter of CO2 quotas defined for companies, and this matter will soon become very important for us. At the moment, the wind park project is profitable due to the Government tariff policy.

According to the inter-government agreement, NIS is supposed to pay 3% of mineral resource rent, although this rent was increased to 7%. What do you think, when will NIS start paying the full price? Will that have any impact on NIS operation?

In this matter, we strictly abide by the formulation clearly given in the wording of the inter-government agreement, which prevails over the national laws. This agreement explicitly states that the amount of mineral resource rent may not be changed until the majority shareholder has returned its investments in the refining segment. I would like to remind you that we invested more than EUR 500 mil. in the modernization of the Pancevo refinery, which was completed in November 2012, and it would be difficult to expect that these funds will return to us as early as in 2013.

Still, the issue of the increase of the mineral resource rent is in the hands of the NIS

shareholder - «GazpromNeft» and the Serbian government. As we are concerned, we can only point out that the current amount of the mineral resource rent allows us to invest actively in the exploration on the territory of Serbia, to implement new complex technological solutions, which are sometimes quite risky, but which promise an increase in the reserves, and enable us to work on the increase of the scope of proven reserves, where, as the final result - they guarantee a stable income and ensure the energy efficiency of Serbia. If NIS is granted the possibility to maintain the current investment activities, the benefits for the Serbian economy will be much higher than in case of arithmetical increase of one taxation item.

I would like to draw your attention to the fact that, in general, the amount of taxes in case of oil businesses in different countries is approximately the same - about 40-50% of the total amount of income. Still, there is a difference in the business segments which bear the greatest load. For example, in Russia, the production is quite well-developed, and the cost price of oil is pretty low, and the deposits are usually easily accessible. Therefore, the mineral resource rent in the RF is much higher than in Serbia and Europe (where the level of the mineral resource rent is significantly lower), where the situation is reversed - the production here is very expensive, oil fields are not large and the access is difficult, and the development of this branch of business is possible only with serious investment support.

According to our estimates, the level of increase in the budget income in case of the increase of the mineral resource rent for NIS from 3% to 7% will not be higher than RSD 3 bln per year - this is slightly more than 3% of our total annual payments to the Serbian budget. I want to say that, for the country, this money will not play a crucial part, but it can have a very negative impact on the investment activities and technological development of our key segment - exploration and production. Therefore, the conclusion is clear - in the long-term, and even the mid-term perspective, the mineral resource rent increase is contrary to the interests of Serbia. This situation is well described by another Serbian proverb - "You don't kill an ox to get a pound of meat".

In our opinion, it is better to avoid this scenario, because the observation of the provisions of the agreement signed between Serbia and Russia will enable NIS to maintain its high investment activities, it will enable Serbia to strengthen its energy independence, and in the future, due to the reserves and its own production, Serbia will become less dependent on the external oil supplies.

NIS is the company which operates with profit after the privatization. When can minority shareholders, especially the Serbian Government, expect the payment of dividends? According to the opinion of brokers, earnings per share will not exceed RSD 200 this year, why is this amount so small when payments will be higher?

In my opinion, the privatization of NIS and the establishment of the model of strategic partnership with "Gasprom Neft" within the scope of the same, is one of the most successful projects of the Serbian Government. I would like to remind you that in 2009 NIS was attractive on a quite conditional basis - oil production had declined during the preceding 10 years, practically no money had been invested in the development of the company, losses had been accumulating, at the same time there were too many employees, and the amount of accumulated debts came close to the sum of one billion dollars. After the re-evaluation

conducted by independent auditors, the starting price of the company was half the amount. Today, almost four years later, we have a completely different situation – NIS brings a stable profit, ensures the stability of the financial system of the country, realizes regional ambitions, actively invests in its own development and operates very efficiently in general. Dividend policy was adopted in 2012, according to which the shareholders will receive their first revenue of NIS shares in 2013. Of course, the final decision with respect to that issue will be reached at the Shareholders' Assembly, but according to the company's budget for 2013, 15% of revenues for 2012 have been allocated for the payment of dividends. Should such a decision be adopted, the payment may be expected by the end of the summer 2013. I am not to adopt decisions on the amount of dividends, but the company's shareholders, so it is very uncertain to talk about the amount thereof. However, talking about the prospective of growth, I may say that our plan includes the continuous increase NIS shares value.

Can our citizens expect the reduction in fuel prices in 2013?

I am sure that the citizens have already noticed that the prices of fuel at NIS petrol stations remained stable in the last few months. The reason is simple – our price policy is very flexible, and we operationally react to any and all changes in market conditions. If you take into consideration the situation with our neighbours – in Croatia the prices increased even three times in January 2013, in Bosnia four times, in Bulgaria and Romania – four times and five times, respectively. However, regardless of the investments into the modernization of the Refinery and due to the increased efficiency, we managed to maintain quite low prices of petroleum products – our prices do not go beyond the average for the region and are the lowest in Serbia.

However, one should bear in mind that the price of fuel does not depend only on a manufacturer, but on the whole range of external factors beyond the manufacturer's control – the amount of excise duties, exchange rate of the national currency, changes in crude oil prices and so on. Production efficiency is only one of the factors, which is not always a decisive one. We expect that RSD will remain stable in 2013, and the price of oil will not significantly change, therefore, my forecasts related to retail price dynamics are mainly positive.

Will consumers get the opportunity to buy the European quality fuel at NIS petrol stations, since the modernization of the Refinery Pancevo has been completed?

Since the beginning of 2013, the Refinery Pancevo has been supplying the NIS petrol stations and partner-companies only with the fuel which complies with the standard "Euro-5", so that our consumers already have such an opportunity. The proof of quality of our fuel is the Euro Certificate, which has already been granted to our company.

However, I would like to draw your attention to the fact that the modernization of Refinery Pancevo has not been fully completed, actually only the first phase has been completed. What follows is the construction of capacities for deep processing of vacuum residues, on which the investment decision will be issued in the nearest future. Based on the scope of investment, it may be compared to the project for construction of MHC/DHT plant, which was commissioned on November 1, 2012. Our task in that segment of operations would include

the increase in the Nelson complexity index (which characterizes a technological level of the refinery development, where the higher index indicates the higher level of technological development of the refinery and higher share of production of high-margin products) until the maximum possible values, which is possible only as a result of continuous investments. But we will not stop at what we have achieved – the plan includes the reconstruction of the Refinery Novi Sad, worth of EUR 100 million, and its transformation into an export-oriented centre for the production of both, naphthenic and paraffin base oils. I would like to emphasize that our "oil" ambitions are not limited to the market of Serbia and the countries of the region – characteristics of the Serbian crude oil "Velebit", which will be used for the production of base oils, will enable us to be competitive in the EU market with our products. The reason is simple – the new refinery will enable the production of not only paraffin oils, common in Europe, but also the naphthenic base oils. Why is this situation so specific? The fact is that Europe virtually has no deposits of oil suitable for the production of naphthenic oils, which is why this type of material must be imported from the New World. And since NIS has such a possibility, thanks to the unique, as I have mentioned above, oil "Velebit", it seems that NIS could reduce Europe's dependence on supplies from America!

In general, our strategic task in the segment of refining is to enter the first or the second group according to the efficiency of refinery operations, in accordance with the methods of Solomon (efficiency indicator in the rating of 200 refineries in the world), which means the implementation of the program aimed to improve the operating efficiency of our refineries, which has already been developed by our experts.

What is the amount of crude oil refined by NIS in its refineries since 2009? What is the share of domestic oil, and what is the share of foreign oil refined?

NIS has refined more than 10 million tons of crude oil in its refineries since 2009, including the amounts refined for third parties by the end of 2009. The share of domestic oil in our structure of refining during all those years amounted to about 1/3. It certainly makes us dependant on fluctuations of oil prices in the world market. However, on the other side, it provides for certain flexibility in pricing and enables us to be competitive in the regional market of petroleum products. We are very serious in approaching the issue of forming the economically efficient package of raw materials for refining – for example, this year, following the comprehensive analysis, we have formed a balanced range of Russian crude oil Urals, the Caspian CPC and the Asiatic VGO.

According to the Agreement on Acquisition of 51% of NIS shares, "Gasprom Neft" was obliged to invest EUR 500 million into development. How much money has been invested in Serbia so far?

Our majority shareholder has fulfilled all its financial obligations – more than EUR 500 million has been invested in the modernization of refining capacities of the Refinery Pančevo and the reconstruction of the factory infrastructure. Please note that "Gazprom Neft" fulfilled its obligations two months ahead of the scheduled timeframe – even in April 2012. In general, in four years of our operation in Serbia, about EUR 2 billion has been invested into the development of all fields of NIS business operations, thus making the company the most significant investment project in recent years, not only in Serbia but also in the Balkans. It should be mentioned that extreme audience also understands that – in 2012 NIS received

the award "The Greatest Investor of the Year". In order to eliminate possible doubts about the seriousness of our intentions, I would like to say that over the years to come we plan to invest EUR 500 million into the development of NIS on an annual basis. Our plans are even more ambitious for the future – the majority shareholder very seriously considers the role of NIS in the development of business outside Russia, therefore, according to my estimates, the investments will only grow.

The issue of NIS property is still not completely clear. How does this fact disturb the company operations?

Indeed, in early 2009 NIS had not more than 1% of total number of company facilities registered. However, with active help of the second shareholder, the Serbian Government, our lawyers were actively engaged in the resolution of this issue during the period 2009 – 2012. Now, the situation has radically changed – about 70 percent of the facilities are registered as owned by the company, we have the right to use a fifth of them, so the number of facilities with the problem status does not exceed 10 percent. Therefore, the ownership problem, which was acute in 2009, may be considered as completely resolved in 2013.

The environmental issues are current for NIS as an oil company. What are your achievements in this area?

Negative environmental situation was changed even in 2010-2011. In 2012 we managed to reinforce our favourable position – in particular, a series of devices in the Refinery Pancevo were constructed whose operation significantly reduced the technogenic load on the environmental situation in Pancevo. They include a new flare, a plant for the regeneration of sulphuric acid, a device for purification of sulphur gases and so on. We act in the same way with respect to the segment of sales – modernized petrol stations are equipped with separators for purification of wastewater and reduction of the environmental impact. The colleagues from the Block Production have recently presented the results of their work in the field of ecology to the public – in the municipality of Srbobran, several pits with the waste generated from the drilling process have been rehabilitated, and this was done with the support of local environmentalists. We intend to pay more attention to the environmental issues in 2013 – this year was declared to be the year of environmental projects in the "Gasprom" group.

What are the prospects of your cooperation with HIP "Petrohemija"?

Our companies have had the status of strategic partnership since 2011. We are related to "Petrohemija" not only through the delivery of raw materials, but also through the infrastructure – the factories in Pancevo are located, as one would say, one across the other. Our partnership received another dimension in 2012 – together with the Ministry of Finance of Serbia, NIS provided the consultancy and logistics support to the management of HIP "Petrohemija" in the process of implementation of the first phase of reconstruction of the company's capacities. I am sure that "Petrohemija" has a great future, and that it will soon, with the help of its partners and the Government, return among the industrial giants in Serbia and the region.

What is the course of your partnership with FC "Red Star"?

Let me point out the following immediately- the general sponsor of FC "Red Star" is the company "Gasprom Neft", not NIS. However, due to the fact that I control the implementation of the sponsorship agreement, I will answer your question. The financial cooperation has been implemented as agreed; the schedule of financial payments has been implemented according to the plan defined under the agreement signed by both parties. We believe that our help, as well as the help of the Government authorities and other sponsors, would help the legendary club to overcome the crisis and return to the elite of the European football.

You have mentioned the technological development of the company as a priority on a couple of occasions. How serious are your intentions in this regard?

I have already talked about the fact that practically no money had been invested into the technological renovation of the company before 2009. The new majority shareholder and the management of NIS came to the conclusion that it was impossible to talk about the maximum efficiency without new technologies. That is exactly why that direction became our priority. Moreover, we plan to devote maximum attention to that issue in 2013 - in our company we have declared the year 2013 as the year of new technologies. This will include the introduction of new technologies in all spheres of business operations - from drilling, refining and sales and distribution, to practices in human resource management. Of course, technical equipment of giants like NIS requires serious funding. That is why the investment program for the year 2013 will increase - we intend to invest minimum RSD 59 billion into the development of the company, which is 16% more than is 2012. I think that it shows how serious we are. Specifically, in 2013 we expect the commencement of the second phase of modernization of the Refinery Pancevo, engagement into an active phase for the construction of a base oils centre, and to finally deal with the unconventional sources of hydrocarbons and compressed natural gas.

In your opinion, what is the greatest business success of NIS in 2012?

It would be logical to deem the project MHC/DHT which was completed within the timeframe and which gave a new quality to NIS in all fields of its business operations our greatest business success in. However, I personally prefer the fact that the Serbian national brand NIS crossed the Serbian boundaries. First, it means that Serbia's influence, especially economic influence, is gradually strengthening. Second, together with my colleagues I will do everything to make the Serbian national brand remind people in other countries only of top quality fuel and services. And third, we will not stop at what we have achieved - we plan to make NIS an undisputed regional leader!