

## Serbia: Kirill Kravchenko, NIS j.s.c. CEO interview for weekly NIN

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2013 was a good year for NIS j.s.c. Novi Sad; however, it was harder than the previous one due to the macroeconomic situation, increase of taxes, excise duties and some other factors. Nevertheless, despite all this, NIS has made progress. We have significantly increased the contributions to the Serbian budget and our direct and indirect obligations to the state are higher by 25 percent compared to 2012, and our share in the total budget revenues in the last five years has increased from seven to more than 13 percent, says Mr. Kirill Kravchenko, NIS j.s.c. Novi Sad CEO for NIN Magazine.

Does this mean that you are satisfied with the year which is about to end?

We have achieved growth in all production parameters. Compared to 2012, we have increased oil and gas production, but also oil and gas reserves, while refining operations have grown by one third. Our market share is also significantly higher as a result of increased sales in the Serbian market and exports, which makes us the second largest exporter in Serbia. All this is accompanied by good financial results – operating profit will be the same, while net profit will be similar to last year's, which is not a bad result considering that the income tax was increased from 10 to 15 percent and depreciation rates were increased after significant investments were made.

If 2013 was harder than the previous one, what do you expect from the next year?

Our macroeconomic assumption is that 2014 will be worse than this one. The crisis is not only a problem in Serbia as it affects the entire region. At the same time, the new budget proposal assumes the GDP deficit of 7.1 percent and we witness the problems the state has with large debts of public enterprises... I also see that the Government invests great efforts in resolving this really difficult situation. Because of all this, we expect that the next year will be a bit harder. It will be a great challenge for us to preserve profitability and our efforts will be focused on reducing internal costs, increasing efficiency, and a small increase in sales, production and refining. We have decided to increase efficiency by applying new technologies, which is extremely important. All in all, I expect that the next year will be worse than this one, but at the same time NIS will do its best to make the results as close as possible to what was achieved in 2013.

You have mentioned public enterprises' debts. Do you find acceptable the idea, which has been widely discussed recently, that debts towards NIS are settled by NIS acquiring certain state-owned companies such as Petrohemija, MSK from Kikinda or the Lubricants Plant?

First of all, our priorities include investments in three largest areas of our business – gas, oil, and gas conversion into thermal and electrical energy. We wish, however, to provide our

assistance in resolving all the problems in this country, but we primarily do this through investments and as of the acquisition of NIS, we have invested 500 million euros a year on average. We also try to help the state in finding strategic partners for companies and sectors that are not within the focus of our business, but which may be in our interest for future cooperation between us and those companies. We may provide assistance in finding a strategic partner for petrochemical industry, increasing its efficiency and other segments of the business, but we do not consider being its majority shareholder an option.

You say that you may help in ensuring that someone else acquires Petrohemija and that you would have a normal partner relationship with the new owner and nothing more than that?

Yes, we have made that clear to the Government of the Republic of Serbia, Prime Minister and competent ministers and we do our best to make it come true.

As you mention the relationship with the Government, there have been some misunderstandings lately, in particular on account of the conclusion which the Government has made regarding NIS development stating that "it is preferable that the Serbian staff should assume key management functions in NIS within the period of five years". What are your views regarding this? Does it mean that the Government is not satisfied with the way NIS is managed?

In the past five years we have never had a situation that a decision is not adopted unanimously, no matter how hard the decision was. As regards this conclusion, it is obviously a technical mistake. Whoever we have talked to has agreed that there was a misunderstanding during the harmonization of technical details. We have agreed to amend the document and it was a mutual decision both of the Serbian and the Russian part. Honestly, I would be happy to have as many Serbian managers in leadership positions as possible and so far we have appointed 40 managers to senior positions in NIS j.s.c. Novi Sad, both those who live in Serbia, and Serbs who were appointed to functions abroad. We have brought those who wanted to contribute to their country and to our company back to Serbia. We have entered into contracts on cooperation with technical faculties and engaged 600 freshly graduated experts in the last three years. And last, but not least, we plan to engage another 200 young experts next year. In addition to that, we have launched several programs of cooperation between Serbian and foreign universities. We engage experts from more than 30 countries as our strategic objective is to ensure that our shareholders are satisfied with the speed of our progress, irrespective of the nationality. Another thing which is very important in terms of relationships with employees – we have a good and constructive cooperation with trade unions, which is very important for us.

The relevant document states that the shareholders should have at least 25 percent of net profit through dividends. Is this possible since you expect that 2014 will be worse than this year?

Lots of efforts will need to be invested in 2014 to preserve the current results. As regards the dividend, I find our policy, which assumes the balance between investments and dividend payment, to be good and at a good European level, because we reinvest the remaining profit and the investments in the years to come will not be less than this year, during which we

have invested half a billion euros.

Do your further investments also include the so-called “Deep Refining” project, and modernization of the Refinery in Pančevo, purporting with years to stop the production of “black” products of poor quality, which now account for 20 percent of the total refining process?

In the last meeting with GAZPROM and GAZPROM NEFT top management, Mr. Miller and Djukov clearly communicated that the majority shareholder was willing to invest in the modernization of the Refinery and we are confident to finish the job in three to four years. I have no doubt that the Refinery in Pančevo will be one of the best in this part of Europe. Therefore the “Deep Refining” will take place. For details we are currently making adjustments, and in late January or early February 2014, we will start to prepare the feasibility study, obtain the permits, so that already by the end of next year we could start working on the Project.

How much money will be needed for that?

A minimum of 300 million euros, but the money has already been reserved in our three-year budget for the next period.

Does that modernization involve the so-called “hydro-cracking” and could NIS become a leading regional player without it, since MOL and LUKOIL have already done that in Romania and Bulgaria, with indications that INA is preparing to do the same in its refinery in Rijeka?

There are two approaches to “Deep Refining”. In the region, however, 90 percent of players use coke, and only 10 percent “hydro-cracking”. And it is true that LUKOIL in Bulgaria has opted for that, but INA and MOL use coke, because it is more cost-effective. In any case, without “Deep Refining” our Refinery could only survive through donations, consequently not being a competitive player in the market, because all the players have already renovated or started renovating their refineries.

Often a source of controversy is the Mining Royalty of only three per cent, which NIS has been paying for exploitation of local petroleum. When will this fee be increased?

But, do you know what is the difference between the royalty here, and the one we would be paying in other countries? Only three billion dinars, whereas this year we will disburse to the state budget about 115 billion dinars! In addition, as a result of the stable Mining Royalty, this year NIS has invested in exploration of petroleum and gas reserves more than 200 million euros, and thanks to that we have in the last five years almost doubled the petroleum and gas reserves in Serbia, and yet in the meantime we have also increased the production. Without such an accurate picture of the trends in the Mining Royalty we could not have invested in the exploration of new petroleum and gas reserves. And that probably means a lot more to the state than the three billion difference due to the Mining Royalty. Moreover, when OMV and MOL entered Romania and Croatia they too had the Mining Royalty unchanged for 10 years and that was not challenged in those countries. That is the situation everywhere. When a big investor enters a country, it wants stability so as to be able to plan

investments.

But it is for that reason that the share of domestic petroleum in the refining has been increased significantly ever since GAZPROM NEFT became the majority owner of NIS?

In 2012 and 2013 refining has increased by 30 percent, whereas the domestic refined petroleum accounts for 40 percent, and imported petroleum for 60 percent in the total refined petroleum volume. The share of domestic petroleum, therefore, has increased, but not radically, as claimed. Having said this, it is also important that our petroleum reserves keep growing, and even more importantly, that we do not send all the yields from domestic petroleum refining to our shareholders in Russia or somewhere else; we invest that in the development of NIS instead. This is an important factor often forgotten by those criticizing us.

This has created a myth that GAZPROM NEFT is here just to take advantage of the domestic petroleum reserves, and then to leave Serbia. How much are these concerns founded?

I will repeat that our petroleum and gas reserves have doubled, while before our arrival, that is for the previous 20 years, they had been falling. Further to the significant investments we now have a lot more reserves than ever before, and we have a larger market share in derivatives, so these stories really are not founded.

Once you had acquired NIS it turned out that there were many unresolved property issues. What is currently happening and does that mean that while signing the Sales Contract, Serbia did not even know what it was selling, or GAZPROM NEFT what it was buying?

It is true that we encountered some unexpected issues, but I would not blame only the Serbian side. We too deserve criticism, because one could ask how it is possible that in the data we had checked it turned out later that we had failed to see some things. The situation has changed significantly ever since. In cooperation with the state, we have managed to acquire 82 per cent of the NIS property, of which 15 percent are for the use, while the status of a minor property share has not been resolved. Therefore, the situation now is much different than in 2009, when we were the owners of one percent of the NIS assets. I would add that the property issue was only an example of the problems that we came across in NIS, but those other problems we have also been successfully resolving with the cooperation of the Serbian Government.

What are your comments on the latest warnings from Brussels that the agreement on the construction of South Stream is not in line with European regulations? Can this slow down or stop the construction of the gas pipeline?

This is not within the scope of my authority, but here I would like to offer a personal opinion. This gas pipeline is very important, not only for the region but also for Europe. Europe is undoubtedly interested in the implementation of the project as well, so I am convinced that South Stream will be started.

The energy agreement with Russia has been criticised from the very beginning. There are

still people, in the Government of Serbia but also on the outside of it, who believe that the agreement must be changed because it is detrimental to Serbia. What are your views on this?

Irrespective of all the talk in the media which aims at spoiling this agreement, I am convinced that the Serbian Government does not want that. The vote in favour of the agreement was unanimous, and it is European practice that, whenever a big investor is coming for a long period of time, it comes on the basis of a strictly defined collaboration framework, which is not subsequently changed. I do not see a risk that could jeopardize the agreement because it is in the interest of Serbia. I would like to remind you that from 2009 up until this year, the taxes and duties that NIS pays into the budget have increased from 60 to 115 billion dinars. In the meantime, the investments have grown five times, and the market share has been doubled. In other words, the European practice, common interest, and the benefit for Serbia are strong enough arguments in favour of the Energy Agreement.

There is an impression in the general public that there are “pro-Russian” and “anti-Russian” ministers in the Government. Have you noticed this division as well?

Our relations with everybody in the Government have been good. Of course, some ministers, in addition to these good relations, truly like Russia, but the Government is not either “pro-Russian” or “anti-Russian”, but rather pro-Serbian. And that is what is most important for this nation. I support that.

Among other things, the document that the Government of Serbia has adopted states that the objective of the Serbian shareholder is increasing rather than decreasing employment, and a social programme acceptable for the trade unions. Do you see this as a criticism of the NIS personnel policy?

Facts suggest that we have the highest salaries in Serbia and the best collective agreement in the region. The total number of people who work on our investment projects and are our employees, or the employees of our partner companies, has been on the steady increase of late, so at the present moment we are facing a different sort of risk. Other European companies want to poach our best employees, and in the upcoming period NIS has to develop the long-term rather than short-term motivation, so that we could keep our finest experts, especially in the geological survey sector.

In your Strategy for the period to 2020, you predict the growth of the NIS share price from the current price of 930-940 to 5,000 RSD. Is that realistic?

We said that that price is possible on condition that we implement the strategy fully and leave behind the crisis that Europe has had in recent years. Unfortunately, the crisis is not over yet, and we have many limitations regarding the estimate of the value of our share, because the Belgrade Stock Exchange is small. If we went public on additional stock exchanges, I believe that the share price would rise.

Does this mean that NIS shares could soon be listed on the London or Warsaw Stock

## Exchange?

This is a decision of the shareholders and not the management. What they decide is how it will be. I still believe that in 2020 a NIS share will be worth approximately 5,000 dinars. Especially if a positive macroeconomic environment is created and if have good “tools” to estimate the value of our shares.

Is there a chance that in the upcoming period small shareholders could get their representative on the NIS Board of Directors?

Our corporate governance has been making quite good headway. For the past two years, we have had two independent members on the Board of Directors. Wolfgang Rutenstorfer spent 10 years as Chairman of the OMV Executive Board, and Stanislav Shekshnia is a French professor at the international business school *INSEAD*. The two of them as independent members of the BoD represent the interests of small shareholders and help us balance their interests and those of the large shareholders.

The black market of petroleum products is becoming more and more of a problem. How widespread has the smuggling become and does this cause a lot of trouble for you?

The black market is always a problem for those who play fair on the market. Together with the tobacco industry, we have developed a plan supported by other players in the tobacco and oil and gas industries. Because smuggling inflicts damage on everyone, but most of all on the state, as the taxes and excise duties are not paid. A conservative estimate that we have made indicates that the state loses at least 100 million euros a year due to non-payment of excise duties and taxes on petroleum products, and an additional 200 million euros on tobacco products. The 300 million euros is a large sum of money for the budget, and I can see a serious intention on the part of the Government to resolve this and bring the black market down to the level which is acceptable both for the state and for the fair players on the market. It is of great importance that the state is flexible and determined to act quickly regarding smuggling, just like a private person would react seeing someone’s hand in their pocket!

Source; NIS