

The Telegraph

BP's Russian deal makes good sense and the West should be cheering

By Liam Halligan , chief economist at Prosperity Capital Management.

PCM specialises in portfolio investments, buying listed stocks and shares in emerging markets, particularly Russia. We're

sizeable players – with \$4.5bn under management, having been in business since 1996. Despite our Russia/CIS-focus, all

the money we manage derives from elsewhere – with our client-base made up almost entirely of Western institutional

investors such as pension funds, endowments and insurance companies, including many from the UK and US.

I mention all this because of the massive J4.9bn share swap between BP, Britain's biggest company by revenue, and

Rosneft, Russia's largest oil major. Given my long-standing professional interest in Russia, and the financial and geostrategic

importance of this link-up, I want to offer comment.

Some readers may turn their noses up at what I'm about to write; a few could even throw personal abuse at me – it

wouldn't be the first time – but don't say I'm not being transparent. My company invests in Russia and I've spent a chunk

of my adult life working in Moscow. Whether that makes my view more valid, or less valid, is for the reader to decide.

BP produces 3.5m barrels of oil daily – more than 4pc of global production. Rosneft is no slouch either, pumping 2.5m

barrels a day. BP has now agreed to swap a 5pc stake in itself for a 9.5pc share of Rosneft, bringing its total Rosneft

stake to 10.8pc. In return, the two companies will work together to extract oil from the Kara Sea above Russia's Arctic

Circle – one of the world's few oil-rich regions that is largely untapped.

This deal is massive for BP – granting it access to a drilling area as big as the UK's share of the North Sea but with much

higher production potential. Russia's Arctic waters may hold 5bn metric tons of oil – 10-times Saudi Arabia's current

annual production – together with 10,000bn cubic metres of natural gas – five times Norway's proven reserves.

After the Gulf of Mexico disaster, BP is now back on the front-foot, having deepened its commitment to the world's

biggest oil producer. That's right – Russia now pumps 10m barrels a day, more than Saudi. And even without the Arctic,

when it comes to gas reserves, Russia is in a league of its own.

The BP-Rosneft deal also has big implications in terms of Western perceptions of Russia – or it should. Rosneft is majority

government-owned. So this is the first ever major cross-shareholding agreement between a private international oil firm

and a state producer.

Many think the "nasty Russian state" wants to grab control of its oil and gas industry. Well, now a big chunk of Rosneft is

being traded with BP. A few months ago, Rosneft agreed to sell off another 25pc of its shares to private investors by 2015

– part of the biggest wave of Russian privatisation since the game-changing voucher auctions of 1996.

Despite Rosneft, more than two-thirds of Russia's oil production capacity is actually privately-owned – by far the highest

share of any of the world's major crude exporters. And the private sector's stake in Russia's oil industry just got higher

still.

So, this deal should kill both the myth that the Russian oil industry is state-dominated and any notion that "BP has had a

terrible time in Russia" – not least through investing in TNK-BP, the country's third largest oil company.

My firm is the largest minority shareholder in TNK-BP. We know the company well, having invested in some of its

constituent parts even before the joint-venture was launched in 2003. The reality is that TNK-BP, combining BP's

geological know-how with the commercial acumen of the company's Russian partners, has been a spectacular success.

Having invested around J5bn, BP has reaped, on our calculations, around J16-J18bn in dividends from TNK-BP, plus the

value of the assets. On today's valuations, having rolled up its sleeves and got seriously involved in Russia, BP has made

eight to 10 times its original stake. TNK-BP represents, quite possibly, the best investment in BP's history.

Russia can be a tough place to do business. BP has had to work for its return. The company has fallen out with its TNKBP

partners from time-to-time. Given the oil industry's strategic importance, the diplomatic fur has flown as politicians

have waded in to the various rows – Western politicians, by the way, to a much greater extent than their Russian

counterparts. Despite the garish headlines, TNK-BP then CEO Bob Dudley never "fled Russia, fearing for his safety",

whatever guff BP's spin-doctors fed to Western journalists.

Dudley lost his job as CEO because TNK-BP's other shareholders, as private individuals and institutions looking to optimise

their investment, thought someone else would do a better job.

Dudley is now BP's CEO. In his very first major act as the big boss he has, with this Rosneft deal, shackled his company's

future to Russia to an even greater extent. Why? Because as Eastern Siberia opens up, as more Russian oil is pumped to

fast-growing Asian markets, as the country's punitive oil taxation regime eases, as BP's Russian gas fields come on

stream, Dudley knows his company's investments in this vast country provide BP with tremendous opportunities. That's

why he wants yet more Russia exposure – something BP shareholders should cheer.

Russia is not for the faint-hearted. As my company well knows, corporate governance abuses remain too common. But

despite the difficulties, BP has already achieved major success. The same goes for a host of other Western commercial

thoroughbreds that have invested heavily in Russia – including Pepsi, IKEA, Proctor and Gamble, Telenor, Carlsberg,

Liebherr, L'Oreal and Auchan. Yes, these firms have had problems, which have been the focus of a great deal of Western

media attention. Much less is made of the returns they've made, and the extent to which they're still investing in a

country which, within my professional lifetime, will be Europe's biggest economy.

This deal will provoke criticism – not least as BP is now "bid-proof". Had BP not benefited from its TNK-BP dividends in

recent years, it would likely have already been swallowed by the mighty US oil major, Exxon. Given Rosneft's backing,

such a takeover is now almost impossible – a reality that will incense BP's rivals.

Fingers will also be pointed as Rosneft benefited from the 2002 break-up of Yukos – the oil outfit once-controlled by jailed

former tycoon Mikhail Khodorkovsky. Yet to paint Khodorkovsky as a "liberal hero" or a "champion of corporate

transparency" is spectacularly simplistic – as my company knows well.

Popular in the West, versions of history presenting Khodorkovsky as "Saint Mikhail" are derided by the Russian public –

not least because they simply aren't true.

Oil importing countries – not least the US – should be celebrating this deal. Between 1999 and 2006, Russian oil

production grew 60pc. During that period, as Chinese oil consumption grew each year, so did Russian supply. It was only

when Russian oil production plateaued above 9m barrels in 2007 that global oil prices span out of control and approached

\$100 a barrel – as is happening again today.

In the end, the world will wean itself off hydrocarbons – but not for some time.

Meanwhile, despite near-insatiable Eastern demand, the West still needs relatively cheap oil and gas. Russia, of course,

has an enormous role to play. That's why, as consumers, shareholders and citizens of the world, we should applaud BP's

latest move.

DOW JONES

Rosneft Shares Rise As BP Deal Seen Boosting Arctic

Ambitions

Shares in Russia's biggest oil producer OAO Rosneft (ROSN.RS) rose to their highest level since April Monday after

the company agreed to swap shares with U.K. oil major BP PLC (BP) and develop offshore Arctic oil and gas

deposits together.

At 1456 GMT, Rosneft's shares were trading 5.4% higher at 244.98 rubles each on Russia's Micex exchange.

The two companies Friday agreed to a \$16 billion share swap, which includes Rosneft taking a 5% stake in BP, while

the U.K. company will get 9.5% of shares in Rosneft. BP will issue new shares to enact the transaction, while

Rosneft will transfer equity to BP now held by the company.

The deal also involves joint exploration of three Arctic offshore blocks comparable to the U.K.'s North Sea deposits,

which contains some 60 billion barrels of oil and gas.

Rosneft said the deal would better position the company to develop the Arctic region, which is critical to its future

plans.

The BP deal "provides a good template for pursuing other licenses with other potential partners," said Rosneft's Vice

President Peter O'Brien on a conference call. "The Arctic shelf is going to be increasingly one of the key strategic

components of Rosneft's development and equity story for the next 10 to 20 years."

The share swap comes as Russia aims to shift more of Rosneft to private investors. The Russian government, which

now owns about 75% of Rosneft, plans to sell 15% of shares on the open market within the next two years as part

of Russia's massive \$59 billion privatization program. Rosneft now floats about 15% of its shares.

Shares in Russian blue chip oil companies have remained undervalued compared with their international peers due

to uncertainties over the oil tax regime as well as rising costs as companies move into new production areas.

"We see the deal as a major positive trigger for Rosneft, indicating BP's confidence in the company's growth," said

Alfa Bank analyst Pavel Sorokin.

BP said it had discussed teaming up with Rosneft to explore the Arctic since 2005, but the idea of a share swap was

first raised by the Russians in high-level meetings just three months ago.

The deal marks Russia's only second attempt to unlock its vast reserves on the Arctic shelf. State gas firm OAO

Gazprom (GAZP.RS) is partnering with France's Total SA (TOT) and Norway's Statoil ASA (STO) to develop the giant

Shtokman gas field in the Barents Sea.

BP has agreed to finance the initial development stages of the three blocks EPNZ 1, 2 and 3 in the Kara Sea, for

which Rosneft received the licenses in October last year.

"The deal underpins Rosneft's superior offshore prospects, which we believe are not accounted for in the stock's

valuations," said VTB Capital analyst Lev Snykov

UPI

BP, Rosneft sign deal to get Arctic oil

European oil giant BP has signed a joint venture with Rosneft, Russia's largest oil producer, to develop the Arctic's

vast oil and gas fields. It's the first significant shares swap between a private and a state-controlled firm in the oil

sector.

BP will hand the Russians nearly \$8 billion in shares for a 9.5 percent stake in Rosneft, the companies said in a

statement.

The agreement would give BP access to Arctic exploration sites in an area as large and promising as the British

North Sea, BP said.

"This unique agreement underlines our long-term, strategic and deepening links with the world's largest

hydrocarbon-producing nation," BP's Chief Executive Officer Executive Bob Dudley was quoted as saying in the

same statement.

With the joint venture, hailed by most analysts, BP would score a major investment comeback after selling major

assets to deal with the aftermath of the Gulf of Mexico oil spill.

"From what we know, it sounds like it's potentially good for BP," Phil Weiss, analyst at New York equities firm Argus

Research, told the BBC. "BP gets access to resources; Rosneft gets access to expertise and knowledge."

The Russians are happy about a new jointly run technology center to be opened in Russia.

"Our future joint venture will utilize the experience and expertise of BP, one of the leaders in the global oil and gas

industry," Rosneft President Eduard Khudainatov said in a statement. "This project is unique in its complexity and

scale both for Russia and the global oil and gas industry. We see it as the next step in developing our relations with

BP."

To be sure, critics are wary that state-controlled Rosneft, 75 percent owned by the Kremlin, could gain too much

access to a Western oil major with assets in Europe and North America.

U.S. Rep. Edward Markey, D-Mass., the ranking on the House Natural Resources Committee, called on U.S.

regulators to review the joint venture.

Dudley himself has had reasons to question doing business in Russia: The former head of Russian joint venture

TNK-BP, he fled the country in 2008 after falling out with other shareholders.

It should soothe critics then, that Dudley himself vowed that teaming up with Rosneft would serve the interest of

consumers, shareholders and governments in the West by tapping into what he said is "one of the world's last

remaining unexplored basins."

British Energy Secretary Chris Huhne also welcomed the deal, calling it "ground-breaking."

"It deepens the business links between the U.K. and the Russian Federation," he said.

Investors seem to agree. Both BP and Rosneft shares rose by 2.5 percent and 3.5 percent, respectively, in Monday

morning trading in London and Moscow.

BLOOMBERG

Rosneft Shares Jump Most in Seven Months on BP Deal

By Torrey Clark

OAO Rosneft jumped the most in more than seven months after the state-run Russian oil producer agreed to swap

shares with BP Plc and form an Arctic offshore venture.

Russia's largest oil producer gained 5.4 percent to 244.87 rubles by the 6:45 p.m. close in Moscow, its biggest

increase since May 26. The 30-stock Micex Index added 1.5 percent. BP rose as much as 2.5 percent today to

512.10 pence in London trading before paring gains to close up 0.2 percent.

BP plans to swap 5 percent of its shares, valued at about \$7.8 billion, for 9.5 percent of Rosneft and set up an

offshore venture as part of a drive to extract billions of barrels of petroleum from above the Arctic Circle, under an

agreement signed on Jan. 14 in London.

"We view the deal as strategically positive for Rosneft especially given that BP will assume initial geological risks and

will bring necessary technology and expertise," Alexander Korneev and Ildar Khaziev, oil analysts at Citigroup Inc. in

Moscow, said today in a note to investors.

Rosneft and BP agreed to explore and develop three blocks in the Kara Sea off Russia's north coast and create an

Arctic technology center. The blocks may hold 5 billion metric tons (37 billion barrels) of oil and 10 trillion cubic

meters of gas, Prime Minister Vladimir Putin said at a Jan. 14 meeting with BP Chief Executive Officer Robert Dudley

at his residence near Moscow.

TNK-BP 'Welcome'

BP's billionaire partners in the Russian oil venture TNK-BP welcome the deal, while seeking more information, Stan

Polovets, CEO of AAR, which represents BP's billionaire partners, said by phone. The venture's board has the right of

first refusal to new BP projects in Russia, he said.

"We welcome the deal," Polovets said by phone. "It's a good transaction for BP, for Rosneft, for Russia and

potentially for TNK-BP."

The Arctic project and the share swap may fall within the exclusivity provisions of TNK-BP's shareholder

arrangement, signed in 2003 and again in 2009 after BP and the billionaires resolved a conflict over strategy,

Polovets said. It's too early for TNK-BP's Russian shareholders to "say what our position is," he said. "We have a

good partnership now and I don't expect that to change."

TNK-BP's shares advanced 6.1 percent to 96 rubles in Moscow.