

Lukoil's Global Energy Reach: is the Russian Oil Giant a Solid Investment?

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Abstract

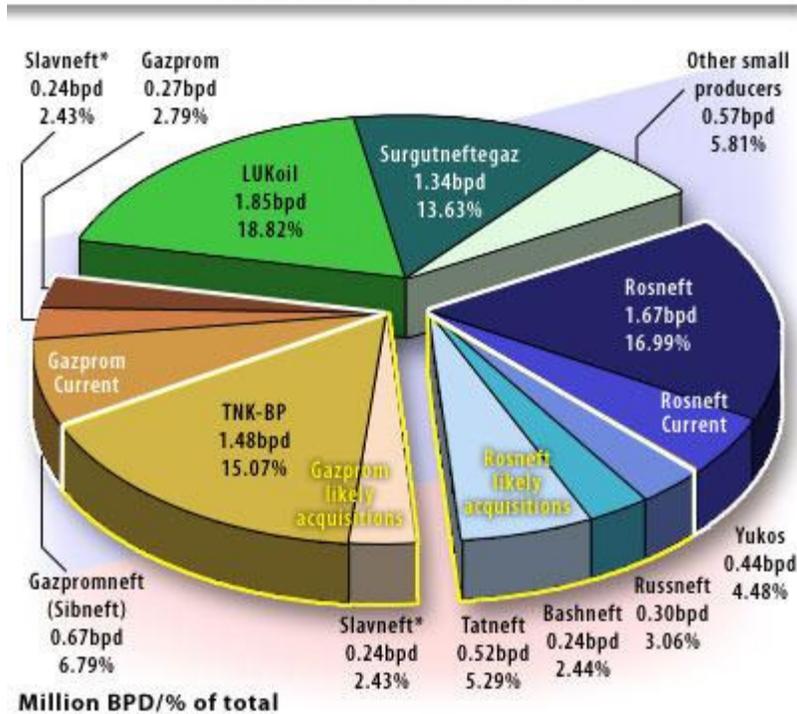
Russia's largest integrated oil company, Lukoil, has partnered with the American energy giant, ConocoPhillips in order to expand the Russian retail presence in the United States and to explore more energy sourcing. The case examines the importance of this Russian company to the global energy market, its implications for American consumers and investors, and the potential geopolitical implications of Russia's energy resources.

Key Words: oil, energy, Lukoil, Russia, global energy market, investment



Lukoil is Russia’s largest vertically integrated oil company. It not only deals with the exploration of oil, but also its distribution, refining and retail distribution. The company was a state entity under the Soviet Union, but was privatized in the 1990’s. Lukoil supplies close to 19% of Russia’s oil production (Figure 1) and approximately 2% of world oil supplies. In addition to aggressive oil exploration, the company has formed a strong alliance with GAZPROM, the state owned gas company and most recently has expanded into petro-chemicals in order to further diversify its portfolio.

Figure 1
RUSSIAN OIL PRODUCTION 2006



Million BPD/% of total
 *Slavneft was privatized in 2002. TNK and Sibneft each purchased 50 percent.
 Source: Special Report: Russia Oil and Energy Report, 2008

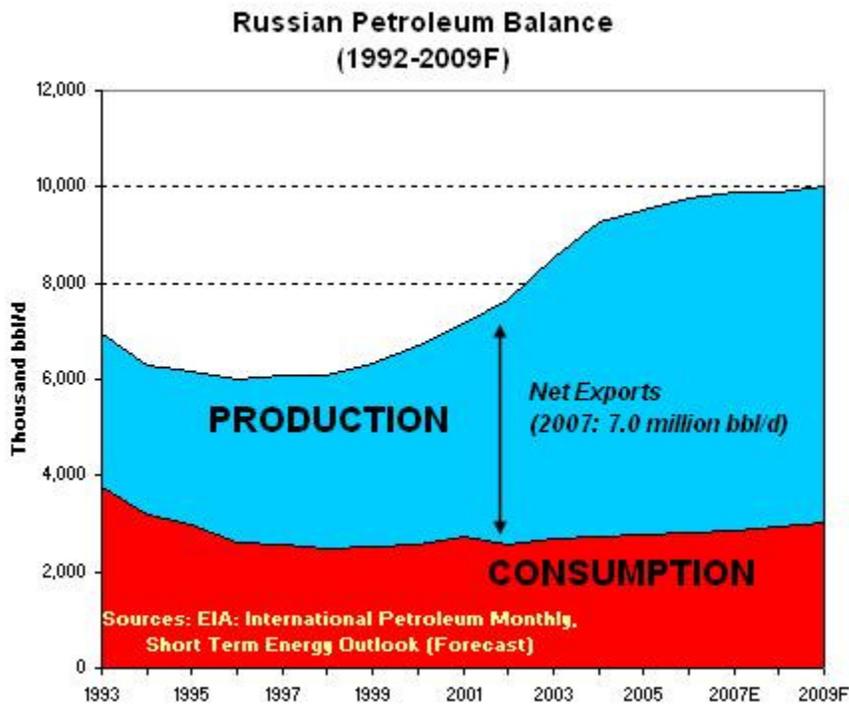
The oil giant has invested in exploration ventures in the Caspian region, South America, Europe, and the Middle East. Lukoil’s diversification strategy also prompted it to invest in oil processing and gasoline retail outlets in the countries of Ukraine, Romania, Bulgaria, Finland, Belarus, the Baltic states, former Yugoslavia, the United States. Not only is Lukoil seeking to spread its influence throughout Europe, the firm has also established a separate arm to focus on investment in North and South America called LUKOIL AMERICAS. Through the purchase of the Getty retail chain, American consumers in the New England area now are purchasing some of their gasoline and fuel oil directly from this Russian company’s over 1,800 retail outlets. The rebranded Lukoil gas stations even offer American consumers a Lukoil credit card.

Lukoil is a truly global company with a base in a transitioning country marked by unpredictable policies and failed reforms. The United States and other developed countries rely heavily on oil to grow their economies. As the world’s appetite for oil continues to grow, Russia will continue to emerge as an important player in the global energy market; it has the seventh

largest oil reserves in the world. Interestingly, Russia is the greatest oil producer that does not belong to the Organization of Oil Producing Countries (OPEC) and has a strong impetus for selling that precious resource to the rest of the world; its economy depends on it. It has been estimated that over half of Russia's state budget revenues are tied to the oil and gas industry.

With the expansion of the Indian and Chinese economies, global demand for energy has risen faster than production, causing prices to increase and allowing Russian oil companies to reap the benefits of these rising commodity prices. As can be seen in Figure 2, Russian oil output has exceeded domestic demand and is expected to continue to do so for a number of years to come. The abundance of excess energy allows Russia and firms like Lukoil to increase their standing in the global community. Some see this situation as an opportunity for foreign investment, others express concerns about the safety of such investments.

Figure 2



Source: www.eia.doe.gov

The price of a barrel of crude oil has been wildly fluctuating over the past decade based on supply and demand. One thing is for certain, the rising appetite for modernization and increasing oil prices are driving governments and oil companies to push for new field exploration. In the case of Lukoil, foreign fields constitute only five percent of the total output, but in the long term, the firm's CEO, Vagit Alekperov, has publicly committed to increasing this proportionately to twenty percent. This is yet another sign of Lukoil's commitment to diversification and demonstrates that Lukoil is a truly global firm with a decentralized business strategy.

Lukoil's CEO, Vagit Alekperov is the largest individual shareholder owning over 20% of the company stock. Mr. Alekperov, has made public statements that an American investor might view as nationalistic.

“The efficient development of reserves directly linked to national security...it preserves the economic integrity of the country...it strengthens national positions in the international arena. The concept has always been the same: in the Russian Empire, the Soviet Union and Russian Federation. It will remain this way, until the ‘oil era’ is over.” (Vagit Alepkerov speech on National Oilmen’s Day, September 2005).

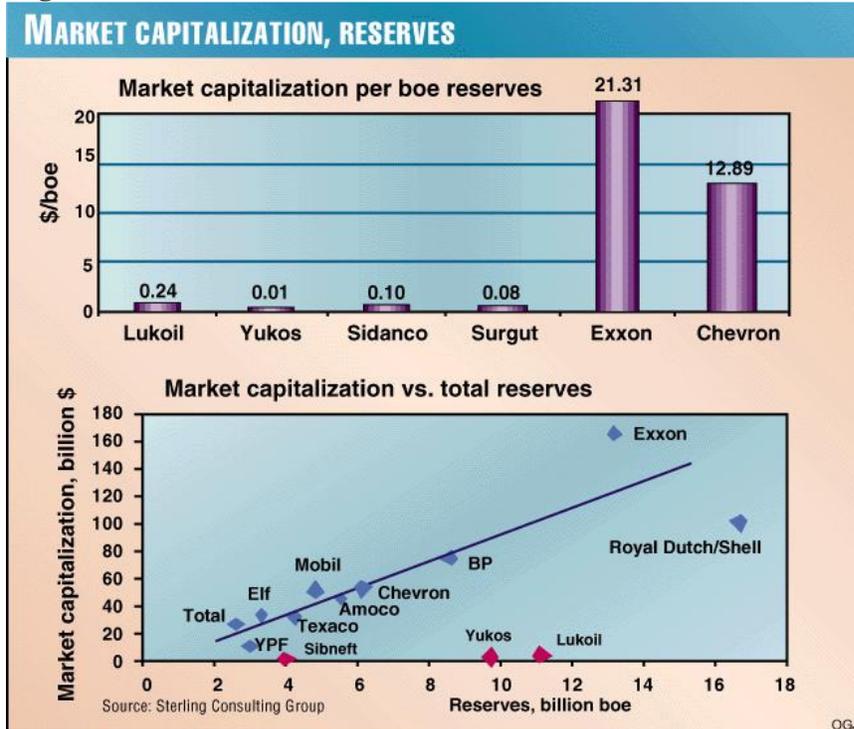
Lukoil’s aim has been to behave as a decentralized company that is both free of Russia’s political influence and eager to attract foreign investment. Some would argue that this is not possible. Lukoil was the largest taxpayer in the Russian Federation in the year 2008. The firm lists its shares on the London Stock Exchange and the NYSE through American Depositary Receipts (ADRs). The value of the ADRs has done well over the past five years (Figure 3), however, it can be argued that the stock is underperforming due to the political risk investors see in Russia today (Figure 4). It may be reassuring to American investors that ConocoPhillips has had a 20% stake in Lukoil since 2005. The acquisition of a fifth of Lukoil’s shares by a US owned company and LUKOIL’s openness to scrutiny by an independent outside accounting commission should indicate that LUKOIL is making a great effort to shed the image of being a corrupt Soviet style national oil giant. Russia’s oil fields are vast and there are many waiting to be explored in Western Siberia and the Sakhalin region. What is troubling to some is the unpredictability of actions undertaken by the Russian government in terms of the confiscation of another private Russian oil company (Yukos) for example, and its aggressive stand with foreign investors. Furthermore, some might also find worrisome that TNL-BP, the joint venture between BP and Lukoil produces 20% of BP’s output, yet yields only 10% of the profits to the foreign investor.

Figure 3



Source: Yahoo Finance.

Figure 4



Source: www.ogj.com

Discussion Questions:

1. What are the geopolitical implications of the rising prominence of Russian oil companies such as Lukoil?
2. Do you feel that Lukoil is a good investment for American investors? Explain your answer.
3. What can Lukoil do to attract foreign investment it needs in order to further its oil exploration?

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