

Rosneft Profiting on Chinese Loan

By [Yekaterina Derbilova](#)

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Rosneft is continuing to draw down a huge loan from China despite amassing a record cash pile because Russian interest rates are higher than the oil producer is paying on the debt, allowing it to profit on the difference.

In the second quarter, Rosneft borrowed another 52.5 billion rubles (\$1.7 billion) from the state-run China Development Bank, bringing its overall debt on the loan to 346.3 billion rubles (\$11.4 billion), according to the oil company's financial results to Russian accounting standards.

A spokesperson declined to say how the money had been spent, but in the second quarter, Rosneft's cash on hand rose more than threefold to 77.4 billion rubles, from 24.2 billion rubles at the end of the first quarter, the results showed.

Meanwhile, Rosneft's financial investments were almost unchanged in the quarter — rising 2.2 percent to 947.3 billion rubles — but its overall debt rose by 53 billion rubles, or by 7.7 percent, to 757.7 billion rubles.

The results make it look as if Rosneft has deposited the Chinese money somewhere, rather than spending it, said Bank of Moscow analyst Denis Borisov. A source close to Rosneft confirmed that the oil company was profiting from the difference in interest rates.

The Chinese loan is linked to the London interbank offered rate, although Rosneft has not disclosed which rate. If LIBOR is less than 2 percent, the margin on the loan is 3.25 percent, but if LIBOR is above 4.5 percent, then the margin would be 0.6 percent. Based on the three-month LIBOR, which is currently at about 0.362 percent, the Chinese money would cost Rosneft about 3.62 percent annually.

But the state oil giant is getting considerably more for its dollar deposits, with free cash earning 6.22 percent to 8 percent annually, according to Rosneft's results to generally accepted accounting principles. That would suggest a difference of 2.6 to 4.4 percentage points.

As of June 30, Rosneft had \$3.12 billion in bank deposits, according to its GAAP reporting, a figure that more than doubled over the second quarter. Rosneft does not disclose where it keeps its free cash, but it has said some of the dollar deposits are at a Russian state bank.

Given the current exchange rate, Rosneft could earn 700 million to 1.2 billion rubles (\$23 million and \$39.5 million) by the end of this year alone on the 52.5 billion rubles from China Development Bank, Borisov said. Profiting from interest rate discrepancies is essentially banking, he said, and Rosneft's financial department has quite a few former bankers who know how to properly manage the company's cash.

Rosneft is trying to take advantage of current market conditions to profit from its free cash, which makes sense, said Pavel Sorokin, an analyst at Alfa Bank.

The oil company could borrow another 111.2 billion rubles from the Chinese bank, which would come in rubles at the day's exchange rate. Rosneft vice president Peter O'Brien said in May that the entire loan would be drawn down by the end of the year.

China Development Bank gave Rosneft the 20-year, \$15 billion facility last spring, backed by an agreement for deliveries of 9 million tons of oil per year. The loan also has a five-year grace period from the time of the first tranche, in May 2009, during which Rosneft pays only interest.

The main goal for the Chinese loan was to refinance debt, and that is primarily how the money is being used, a Rosneft official said. The company does not disclose how much debt it has to repay by the end of the year.

According to its GAAP report, Rosneft had \$22.2 billion in debt at the end of June, \$6.9 billion of which is short term. Of that figure, at least \$2.4 billion would need to be repaid by the end of 2010, the report showed.

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