Russia

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Russia is, by a considerable margin, the largest of the 15 independent states created after the dissolution of the Soviet Union on 26 December 1991. Covering an area of some 17 million square kilometres, the country has a population of almost 147m and a GDP of 1.65 trillion dollars according to 2018 figures.

Since a peak of 8.5% in 2007, Russia's GDP growth has fluctuated between positive and negative. Last year's 2.3% may be significantly reduced by the end of 2019. With growth of just 0.7% posted to June, the economy faces challenging times as global sanctions and Russian counter-sanctions take effect. While, the economy is expected to recover, the geopolitical climate has created something of a "Russia First" approach, allowing national oil and lubes producers to flourish.

As a result, Russia produces relatively cheap oil and fuel, although there are significant price and supply variations between well-developed suburban areas and under-developed rural regions.

The vehicle parc and manufacturing

Russia's vehicle parc at the start of 2019 was 52m vehicles, excluding off-highway, of which 80% were passenger cars. Light commercials accounted for around eight percent, HCVs a further seven percent and motorcycles four percent.

Russia's car production capacity is more than three million vehicles annually. However, in 2018 only 1.5m were produced. As well as domestic OEMS, such as AvtoVAZ and UAZ, many global automakers also have assembly plants in Russia including Hyundai, Mazda, Volkswagen Audi Group, PSA, Renault-Nissan-Mitsubishi and Toyota.

Despite production overcapacity, in 2019 Mercedes-Benz opened an assembly plant near Moscow with a 25,000 unit capacity, while Great Wall-sponsored domestic OEM, Haval, launched its 150,000 unit SUV assembly plant in Tula area. Meanwhile, Ford has closed its three car plants, leaving only a light commercial vehicle presence.

While the passenger car parc averages around 13 years old, more than half of Russia's LCV and HCV parc is more than 20 years old. Domestic manufacturer, KAMAZ, accounts for more than 50% of new HCV sales in Russia, thanks to successful joint ventures with Cummins and Mercedes Benz, and is set to strengthen its position.

Vehicle sales

The Russian automotive market has experienced peaks and troughs over the past 20 years in clear four year cycles. Analysts have mixed opinions regarding today's market – some seeing growth which others define as stagnation, largely affected by reductions in disposable income impacting volume and turnover. Russian car sales reached a record high of 2.8m units in 2012, with 2019 new car sales expected to reach 1.6m, slightly below the previous year.

Demand is dominated by local brand, Lada, owned by AvtoVAZ as part of an Avtovaz-Renault-Nissan-Mitsubishi Alliance. Lada's 21% market share eclipses KIA's 12% and Hyundai's 10%, with Renault, Toyota, Volkswagen and Skoda also in the mix.

Base oil production

Russia has massive oil and natural gas reserves, although US-led sanctions have restricted their full exploitation, slowing growth in this sector as large investment is needed. Even so, Russia remains the third largest country by production at circa 11mb/d.

Following the end of the Soviet Union, Russian base oil production capacity was an estimated

4.2m tonnes. Between 1990–2014, several base oils production facilities, leaving current base oil capacity at an estimated 2.38m tonnes, operating at around 87%.

Historically, base oil production was focused on Group I. However, with Group I domestic and export demand shrinking significantly, there is now a production surplus. New refineries operated by Rosneft, Gazpromneft and Lukoil are producing Group I, Group II and Group III base stocks.

The Russian market for Group II is relatively small, mainly due to lack of regional supply and the penetration of Group III for high-performance lubricants.

Russian crude oil contains relatively high levels of sulphur, restricting Group III production as it requires additional processes to reduce sulphur content in final products, such as fuel and lubricants. Delays in implementing GOST Standard R52368-2005 for diesel meant Euro 5 diesel (10ppm S) was only implemented in 2016, as were gasoline sulphur limits (10ppm max).

Lukoil Group is absolute volume leader in terms of production capacity and quality, although it now only operates two base oil refineries - in Nizhny Novgorod and Perm – after its Volgograd site stopped base oil production in 2015.

Rosneft occupies second place after acquiring Bashneft in 2016, while Gazpromneft operates one own-brand refinery located in Omsk, sharing Rosneft's Yaroslavl refinery for Group III production.

Lubricants production

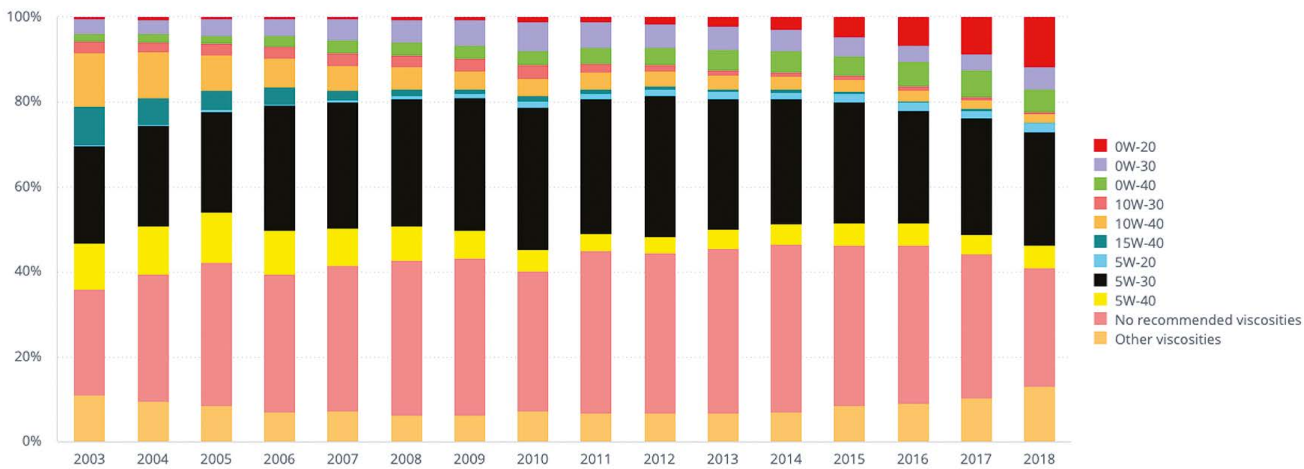
The Russian lubricants market is slowly restructuring from a Soviet Union-type economy to an open market. This transformation is slowest in the industrial lubricants segment. Due to the weak Rouble, and the resulting relatively low cost of Russian labour, there is greater viability in local lubricants production to replace imports and reduce or avoid forex risks.

Total demand for finished lubes in Russia is estimated at 1.6m tonnes, with industrial lubricants accounting for 45%, CV lubes taking 36% and passenger car oils accountable for 19% of the total market. About 60 locally produced and imported lube brands are marketed in Russia.

Key lube producers are mainly subsidiaries of Russian oil majors: Lukoil-Lubricants, Gazpromneft-Lubricants and Rosneft-Lubricants. Global brands with local blending operations – Shell, Fuchs and Total - take most of the remaining share. Two independents blenders, Obninskorgsintez and Delfin Group, market own brand products as well as providing toll-blending lubes to other producers.

Russian imports of automotive and industrial lubricants have remained relatively stable since 2016, showing slight recent growth at 270k tonnes annually. Brands include Mobil, Castrol, ZIC, Total Elf and LiquiMoly, with Shell also importing some base oils and finished products. Lubes additives are largely imported, with local producers such as Qualitet and Lukoil's Naftan refinery restricted in product portfolio and technology.

The lubricants market

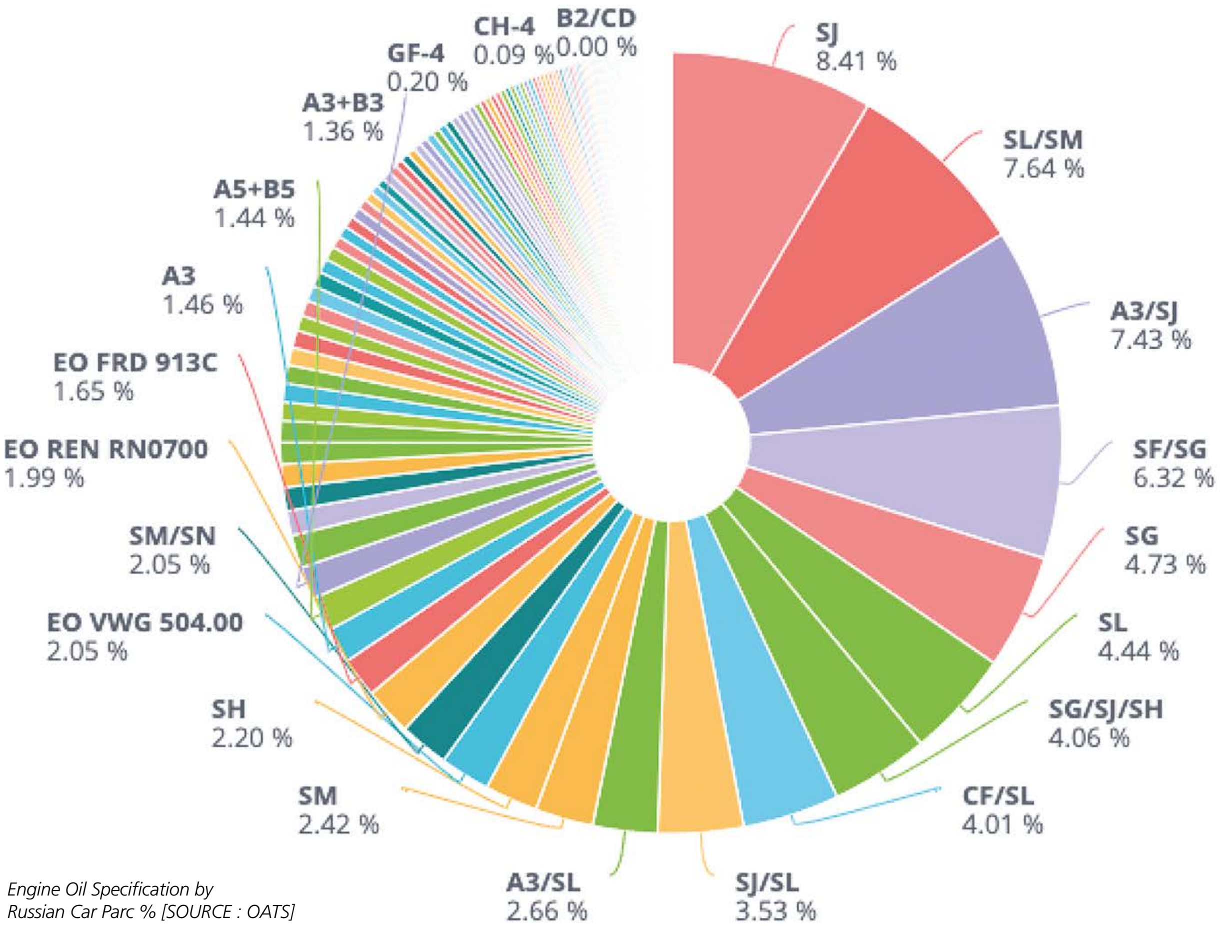


Engine Oil viscosity. Parc % by year of manufacture [SOURCE : OATS]

Synthetic and semi-synthetic lubricants account for more than 60% of Russia's passenger car market, 30% of CV sales and five percent of industrial speciality lubricants. However, because of the ageing vehicle parc, whilst 0W-X products are gaining ground, it is the 5W-X lubricants that are currently generating the strongest demand.

OEM-branded lubricants are mostly sold as first-fill or warranty products, with Lukoil being the leading OEM supplier. OEM-branded oils are dominated by the Japanese marques such as Nissan, Toyota, Honda, Suzuki, Subaru, Mitsubishi, Mazda.

However, some OEMs are trying to create aftermarket traction with lubes and parts brands, such as Renault's Motrio and Peugeot's Eurorepar. Those importing finished product use fully-owned or partner distribution networks, such as BP Castrol's Setra Lubricants, SK's Eneos lubes and Yubase base oils, Total Vostok or LiquiMoly Russland.



Engine Oil Specification by Russian Car Parc % [SOURCE : OATS]

Lubricants are generally sold via traditional channels: dealerships, aftermarket workshops and retail outlets, although internet sales are showing steady growth. The DYI passenger car segment prefers four litre bottle sizes for engine oils and one litre packs for gear oils for Passenger cars. Commercial demand is for 20 litre packs, with 200 litre drums mostly used by OEMs and dealerships.

In Summary

While largely following the global trend of high-performance synthetic lubricant growth, Russia is being held back by an ageing passenger and commercial vehicle parc, as well as slow adoption in the industrial sector.

However, with total lubricants volume expected to reach almost 1.8m tonnes in 2026, Russia's lubricants market is one of the largest and most competitive in the world. It is set to provide considerable opportunities, particularly to Russian producers and those non-Russian-based oil and lubes manufacturers prepared to invest in local production and distribution infrastructure.

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