



## FROM HARVEST TO RENEWAL



The Russian oil industry is currently enjoying a 'brownfield renaissance'. But in the long-term, only through investment in renewal, will companies ensure that they continue to deliver high performance to shareholders, employees, and to the wider Russian economy argues **Larry McVay**, Deputy Chief Operating Officer, TNK-BP

TNK-BP considers maintaining its reserve base a matter of fundamental importance. The ability to identify, appraise and book new reserves is key to sustaining the business in the long-term. This holds true for TNK-BP as a

company, but also for the Russian industry as a whole.

Much has been said about the high production growth rates achieved by Russian companies. Indeed, Russia's oil industry has been the star performer

globally. But the high growth rates witnessed today make reserve replacement and sustainability truly important to the industry. Whether Russia remains a great oil and gas producer will be determined by companies' ability to add reserves beyond what they have produced already.

The importance of maintaining a long-term reserve base is becoming increasingly accepted in Russia. Recently, a seminar organised by the Minister of Economy German Gref and the Minister of Natural Resources Yuri Trutnev was dedicated to sharing the experience of US regulation of the licencing regime. The issue of unified exploration and production licences was discussed. These licences, commonly used in the US and other regulatory systems, automatically extend to cover the productive life of the field – provided the licence-holder fulfills all the terms and conditions.

If similar provisions are included into Russia's new subsoil regulation, it will allow Russian companies to reflect more accurately their reserve potential. This, in turn, would allow Russian companies to be valued closer to international multiples, and would encourage the industry to make long-term investment into adding reserves.

### Building a long-term business

One key aspect in the goal of maximising the long-term value of TNK-BP is maximising production. While TNK-BP has successfully delivered a high rate of growth (14% production growth in 2003), it is as important to replace and add reserves that will support further production, and move resources from the 'probable' into 'proved' categories. Otherwise, growth becomes unsustainable.

Until recently, the focus of Russian heritage companies had been on inorganic expansion through acquisitions, providing immediate growth and returns over the short term. This was the right approach given the market conditions at the time, and it certainly propelled TNK to the forefront of the industry. But, in terms of organic reserve replacement, heritage

## TNK-BP AT A GLANCE

- Formed in September 2003 as a result of the merger of TNK, Sidanco along with BP's oil assets in Russia and Ukraine.
- The company is 50% owned by BP, and 50% by the Alfa Access & Renova Groups.
- May 2004 saw the publication of first independent company-wide reserve audit by DeGollier and McNaughton.
- The audit confirms that as of 31 December 2003, total proved reserves increased from 4.1b to 4.3b barrels. Of these, Proved Developed reserves grew from 3.2b to 3.4b barrels of oil equivalent.
- Total Proved reserves decreased from 9.4b to 9.0b barrels. SPE Proved Developed reserves moved from 6.1b to 6.0b barrels of oil equivalent.

companies were able to achieve an average of 25-35% of annual production.

Following the merger of TNK-BP, we have shifted the focus to creating longer-term value that is driven by organic growth, efficiency of capital investment, and effective management of existing assets. This does not mean that short-term objectives have been supplanted or that there will be no inorganic acquisitions. On the contrary, TNK-BP plans to maintain a high rate of growth both through organic and inorganic means.

The shift in our development paradigm may be best described as the change from 'harvesting' to 'renewal', a shift from a short-term focus to focusing on the long term. This means that we plan to invest in renewing our hydrocarbon reserves and our technology; and also that we will invest in our people and in the renewal and preservation of the environment.

On the reserve side, in 2003 we replaced 133% of production on the SEC basis, and 83% of production on the SPE basis. Our five-year strategy sets the goal of attaining a minimum of 75% reserve replacement, eventually attaining 100% replacement of production on an annual basis. Because production keeps growing, this means that TNK-BP is committed to making the investment necessary to identify more and more reserves each year in order to sustain the long-term future of this business.

### Replacing reserves

Exploration is a key aspect of our work to ensure renewal and long-term sustainability. TNK-BP has a unique advantage of having virtually unlimited access to BP's in-house exploration expertise. In 2004, we plan to invest approximately \$40m in exploration, and another \$30m in appraisal work – roughly double our spending in 2003. Having integrated BP expertise into the new company, we are beginning to see a positive impact. For instance, in 2004, our appraisal success rate has been 75%. Finding costs have been \$0.43/bbl for our exploration activities, and \$0.28/bbl for our appraisal work. These statistics form a virtuous circle: when exploration is efficient and delivers good returns, it encourages the company to invest more in exploration.

Another key area for reserve replacement and addition is through improved reservoir management and production technology. For example, at Samotlor, application of new production techniques used by BP generates around 750b barrels of new reserves for every 1% increase in the recovery rate. Improved reservoir management, reservoir studies and proper depletion planning are key to converting our vast resources into proved reserves.

### Investing in people

It is no less important to make long-term investment in our people – retaining and renewing our intellectual capital. This includes a commitment to invest

in education and professional growth. Through a programme of seconding professionals into the company for a limited time, BP experts come to Russia to share knowledge with their Russian colleagues while a reverse secondment programme allows Russian specialists to go on to BP assets and institutions.

**Health, safety and environment**

A strong investment in renewal is also demonstrated in the areas of health, safety and the environment (HSE). Significant legacy issues exist for all Russian oil companies in terms of environmental damage and a high rate of incidents and traumatism in their operations. As part of our transformation, we have committed to changing the status quo in our company.


Since TNK-BP began operations in October 2004, we have implemented a fundamentally new company-wide HSE

incident reporting system. It provides data for all major incidents and high potentials, allowing us to undertake root cause analyses and develop prevention measures. Also, unified company-wide safety standards have been issued across all subsidiary companies. We have adopted strict international vetting standards for all ocean-going tankers carrying our production. We are working to introduce standard protective equipment for all workers across the various subsidiary companies. As we go forward with developing new large projects, all new greenfields will be engineered according to internationally accepted standards. TNK-BP will be the first Russian oil company to do that.

**Investment in renewal**

Consistent investment in renewal will allow us to build TNK-BP into an

industry leader. This does not mean the largest company in the industry but it implies a company that is the most profitable, most efficient, and the one that operates to the highest international standards. Investment in renewal of the company will help to ensure that TNK-BP continues to deliver high performance to its shareholders, its employees, and to the Russian economy consistently over the long term – even when the current phase of Russia’s ‘brownfield renaissance’ runs out. This, I strongly believe, is also good for Russia, its economy, and for the communities where we operate.

*Larry McVay is Deputy Chief Operating Officer of TNK-BP, soon to assume the role of the COO. He currently chairs the Company’s Operations Committee, and the Upstream, Downstream, Technology and Oilfield Services.* 



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