

**M&A NEWS****Eni and Gazprom sign an agreement for the South Stream Project**

Eni and Gazprom signed a further agreement related the South Stream project, in which the parties agreed to use a joint special purpose vehicle (SPV) for the commissioning of the marketing and technical feasibility studies of the project.

The new structure will be governed by a shareholders agreement.

The agreement is a further significant step for the implementation of this strategic project for the Russian and European gas markets.

Eni and Gazprom, together with the Italian and Russian governments, will develop top level discussions with the governments of the transit countries of the South Stream pipeline as well as with the other possible partners in the coming months.

In its offshore section, the South Stream will cross the Black Sea from the Russian coast of Beregovaya – the same starting point of the Blue Stream pipeline – to the Bulgarian coast, with a 900-km pipeline reaching a maximum water depth of more than 2,000 meters. For the onshore section two different routes from Bulgaria are being studied: a route towards northwest and the one towards southwest.

Eni and Gazprom will carry out the project using the most advanced technologies in full respect of the strictest environmental criteria. This project represents an important and substantial contribution towards strengthening the security of the European energy supply.

*22 November 2007*

## The Key Developments and Trends in the Russian Oilfield Services Market

The following material is based on the study **Oilfield Services Market in Russia 2007: Analysis and Outlook** by RPI released in November 2007. The first part of this material presents general overview of production and drilling activities in Russia in 2006 while the second one dwells on key developments in the Russian oilfield sector.

According to RPI assessment, the market has grown 22% in 2006 reaching US\$ 10.1 billion in the key oilfield service sectors (excluding equipment casing and tubing, which account for estimated US\$ 4 billion) providing the companies present in the market with the opportunity to expand their businesses. The year 2007 has so far been just as interesting for the industry as the market continues its expansion.

Production drilling has unequivocally been the main source of this growth. It topped 11.6 million meters in 2006 and is projected to reach from 13 to 14 million meters this year marking a very significant leap forward and contributing to the positive forecast for further development of this sector. Being a major factor affecting the overall situation in the oilfield service market, the fast paced growth of drilling has been premised by the changes in the technical and geological situations in the main producing regions of Russia. Changing conditions in geology that put limitations on intensification of brown field production will continue to demand increase in the drilling operations. Vast production intensification opportunities in Russia have led to insufficient drilling in the past 5-10 years thus limiting production capacity for future expansion. Growth in drilling will put significant constraints on existing capacity driving costs up in the next several years. To offset capacity limitations the seasonal fluctuations have been alleviated setting up the possibility of increasing the utilization of drilling capacities. Exploration activities remain stagnant today amid high and growing exploration drilling costs and proper financing of the activity will be determinant to the future sustainability of production in Russia. RPI believes that the state will play an important and growing role in financing exploration in the future.

### Timan Oil & Gas signs a Memorandum of Cooperation with a Gazprom subsidiary

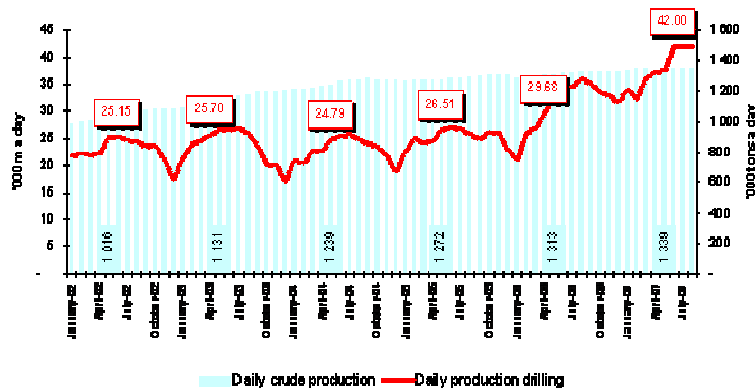
Timan Oil & Gas plc announced its signing of a strategic Memorandum of Cooperation ("MOC") with Zapsibgazprom OAO, a Gazprom's subsidiary. The purpose of the MOC is to set out the principles of strategic cooperation between Timan and Zapsibgazprom for the development of the Timan's oil assets. In the Russian Federation, such agreements are commonly the first step in agreeing binding commitments at a future date.

It is expected that within two months from the signing of the MOC, the working teams and committees will be set up with the objective of developing specific areas for cooperation.

The main principles set out in the MOC for future discussion are as follows:

- Participation of Zapsibgazprom in the exploration and development of Timan's oil and gas portfolio, which could result in investments of up to US\$ 500 million;
- Participation of Zapsibgazprom in the development of Timan's Nizhnechutinskoye oil field in the Timan-Pechora Basin, involving drilling and construction of facilities for approximately 2,600 oil wells;
- Participation of Zapsibgazprom in Timan's exploration activities at Khudayelskoye field in the Timan-Pechora Basin (4 appraisal / exploration / production wells) and in exploration of Timan's off-shore licenses in the Russian section of the Caspian Sea (2 exploration wells);
- Cooperation to ensure that necessary equipment is secured and that all staff is appropriately trained;
- Cooperation in relation to technical and operational support required in drilling and

### Daily production and daily drilling footage, 2002-2007



There is plenty of room for increasing the efficiency of the existing capacities. The existing drilling rig stock counts about 1,200 rigs with the average drilling footage per rig reaching a little over 20,000 meters, which is a comparatively low rate. This productivity certainly has objective causes – wide geographical spread of operations, harsh climate conditions and outdated technology. Given that the average drilling rates per rig will be doubled the existing rigs will be capable of drilling up to 20 to 25 million meters per year, which is presently impossible due to the use of outdated technologies and the weariness of the equipment. Amid shortages in capacity the drilling operations grew by 26% in 2006 and will most likely top increase by up to 25% or even 30% this year. Along with growth in drilling volumes will grow technological requirements to drilling – there will be increasing number of horizontal wells and technologically challenging ones.

The possibilities for recovery enhancement are dwindling on the existing well stock which results in accelerated decline rates in existing brown fields. It is perfectly reflected in the current trends of the application of hydraulic fracturing. While the number of hydro fracs on carry over stock has risen sharply making for the total of 4,400 operations in 2006, or a 10% increase from 2005, the efficiency is falling as same volume of crude oil were extracted as in the previous year. Other recovery enhancement techniques also face challenges – the efficiency of each bottom-hole zone treatment operation is growing amid declining number of operations which have gone down by 27% from 2001 to 2006. Artificial lift optimization operations are also in decline having decreased by 22% from the 2003 levels due to the problems with the reservoir pressures and lack of electrical power capacity. The effects of artificial lift optimization are also in decline almost all regions.

building necessary infrastructure at Timan's subsidiaries NGPT, KNG and Geoterm.

Under the MOC, which is non-binding at this stage, it is also possible that Zapsibgazprom may agree to participate in either the share capital of Timan or its subsidiaries at some point in the future.

8 November 2007

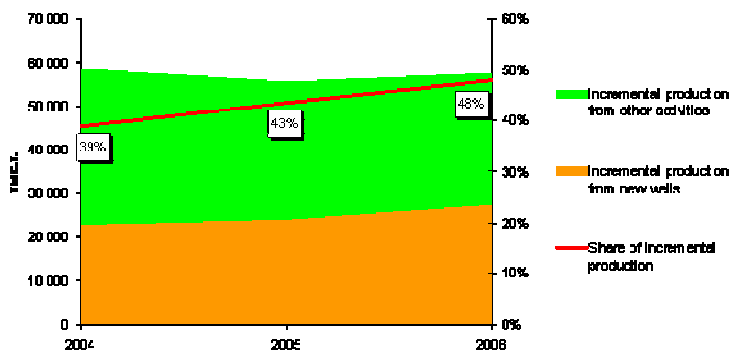
**Halliburton buys Russian drilling company**

Halliburton has announced completion of acquisition of the Russian drilling company Burservice.

Halliburton's vice president for Russia, Simon Turton, said the deal allowed the company to "expand our operations to serve oil and gas customers in northern Russia, thanks to Burservice's outstanding reputation for service quality in Russia's Timano-Pechora region." It also provides Halliburton with additional capacity. Turton said his company had expanded directional drillings and measurement-while-drilling in West Siberia, operating from Halliburton's main base in Nizhnevartovsk. The deal to acquire the Russian service company was announced in July 2007.

Burservice was established in 2004 and provides directional drilling. It is based in Usinsk, in Komi, and has around 100 employees. By the way of comparison, founded in 1919, Halliburton is one of the world's largest providers of products and services to the energy industry. With nearly 50,000 employees in approximately 70 countries, the company serves the upstream oil and gas industry throughout the life cycle of the reservoir-from locating hydrocarbons and managing geological data, to drilling and formation evaluation, well construction and completion, and optimizing production through the life of the field..

**Additional production from production drilling and intensification methods in Russia, 2004-2006**



The decline of production caused by the aforementioned factors forces companies to drill more which is positive for the industry making drilling the driving force of the market development for the next 5-10 years. This situation suggests the lack of drilling equipment which exists now will be even more apparent in the future.

The oil companies are actively developing their own service assets as both Gazprom and Rosneft are placing orders for new rigs. Large drilling companies will be the main beneficiaries of this situation. For instance, Drilling Company Eurasia made good profits off this growth as its main customer LUKOIL significantly increased the amounts of drilling. TNK-BP is likely to follow and Rosneft will beyond any doubt increase the scope of drilling operations as well.

Generally, the ongoing consolidation within oil companies narrows the operating space for independent companies and stimulating further acquisition of service capacities by large state owned companies. The latter has to deal with the increased demand for drilling services combined with the lack of equipment which drives up the cost of drilling as the prices charged by contractors have risen by estimated 10% in production drilling and 20-30% in exploratory drilling. Large drilling companies as well as other key players of the oil market are expected to further grow drilling capacities. This will continue the trend which is already in place as Gazprom has ordered 11 rigs from Uralmash Drilling Equipment while Rosneft also bought the total of 11 rigs from 3 manufacturers including German producer Bentec GmbH and the Volgograd Drilling Equipment Plant. Drilling Company Eurasia has also been growing capacities having acquired 8 rigs since the middle of 2006 including 2 from Tourneau Ellis Williams and 2

Halliburton's chief operating officer, Andrew Lane, in an earnings call in July, said the deal provided his company with "a new area for expansion and is well-positioned to capitalize on the growing horizontal drilling market in Russia. We plan to expand their current service offerings to include our rotary steerable and LWD technologies."

The provision of services in Russia is expected to be a booming industry over the next few years as the more accessible deposits become depleted and operators are forced to look further and tackle tougher challenges. In 2006, the market was said to be worth around US\$ 10 billion and is growing at a rate of 10% p.a.

*1 November 2007*

#### **SurgutNefteGaz wins an auction for a subsoil use license in Yamalo-Nenetsk**

SurgutNefteGaz has won an auction held by Yamalo-Nenetsk Agency for Subsoil Use for an exploration and production license within Zapadno-Russkiy block.

The total recoverable hydrocarbon reserves of the block are estimated at 21.9 million tons of oil, 40.0 bcm of gas and 6.5 million tons of condensate under C3 classification. Zapadno-Russkiy block was acquired for the total consideration of RUR 319 million (ca. US\$ 13 million), which is ca. US\$ 0.03/boe of C3 recoverable reserves.

*1 November 2007*

from Izhdriil HunHua.

We expect the growing costs of drilling to affect prices in other segments of the service market which have excessive capacities. In an effort to reduce OFS costs, oil companies will try to cut already depressed service prices in segments like well servicing and possibly logging of existing wells. Any technology that will allow for increased speed of drilling will be on the other hand in high demand – high efficiency drill bits, top drives, and MWD and LWD systems are likely to become key segments for growth.

While consolidation of OFS assets is a key for survival and efficiency gains in Russian OFS market, the consolidation process in itself will lead to a significant increase of the price of the capacities available for consolidation. Therefore, further development of the market demands both consolidation and a significant hike in efficiency especially in the face of new competition from Chinese and Western contractors.

One of the surest ways to increase the efficiency of the utilization of drilling capacities is setting up a rig count for Russia as the lack of information seriously undermines the ability to use the available assets effectively. RPI and Baker Hughes are initiating set up such a database in Russia. The system development will depend on participation of all major oil companies and drilling contractors. By contributing data which will be accessible to all market participants major player will significantly impact efficiency of assets utilization and equipment supply. Such measures will improve the transparency of the industry and make all key information available.

#### **Oilfield Services Market highlights:**

- 1. The market is growing at a fast pace with large service companies associated with oil producers capitalizing on this growth.**
  - The oilfield service market has grown by 22% reaching US\$ 10.1 billion in the main segments of oilfield services (excluding equipment, casing and other – for market definitions see chapter 4)
  - Production drilling was the main source of this growth as it increased from 9.4 million meters in 2005 to 11.6 million meters in 2006. This segment accounted for 57% of the total market growth in financial terms
  - The scope of production drilling continued growing in 2007 and according to RPI's forecasts will reach 13-14

## FINANCIAL ADVISORY NEWS

### Gazprombank places RUR 20 billion bond issue on MICEX

In spite of some difficulties on the global debt capital markets, Gazprombank managed to place its 5-year bond issue in the amount of RUR 20 billion. Semiannual coupon rate is set in the range between 7.15% and 7.40%. Another 5-year bond issue is planned to be placed by the Bank on 29 November 2007.

22 November 2007

### Urals Energy raises a US\$ 270 million loan

Urals Energy, a leading independent exploration and production company with operations in Russia, announced the completion of a new project financing loan agreement to repay the Goldman Sachs facility and fund the development of the company's key asset at the Dulisminskoye field in Eastern Siberia. The loan enables development of the field to its estimated peak production of 30,000 bopd by 2011 and fully unlocks the field's 464 mmboe of independently audited 2P reserves. Sberbank, the largest bank in Russia, has agreed to provide a total of US\$ 270 million to OOO NK Dulisma, a fully owned subsidiary of Urals Energy, under a long term debt facility. The loan is secured against existing shares of OOO NK Dulisma and existing Urals Energy shares pledged as security by the two company's largest shareholders and senior managers.

The facility is structured in two stages. An initial US\$ 130 million is provided under a 6 year term loan, which will finance the full and immediate repayment of the principal and all other liabilities relating to the debt facility which was arranged in January 2007 by Goldman Sachs. The remaining US\$ 140 million, also to be loaned for 6 years, will be available for

million meters in 2007 pending on the winter conditions

- Alleviation of seasonal fluctuations has been evident in drilling allowing the drilling companies to utilize their capacities better
  - Main beneficiaries of the market growth are subsidiaries and associated companies of large oil companies:
    - ⇒ Drilling Company Eurasia (incremental drilling of about 800 thousand meters or 40% of the total market increase)
    - ⇒ RN-Burenie (incremental drilling of about 280 thousand meters or 14% of the total increase)
    - ⇒ SBK (an addition of about 163 thousand meters or 8% of the total increase)
    - ⇒ Drilling departments of Surgutneftegaz accounted for about 5% of the growth in drilling
- 2. Capacity constraints in drilling will prevail in the upcoming 2-3 years and large companies will actively build up their capacities.**
- Consolidation of oil companies continues to squeeze space for independent market participants and supported the development of their own service capacities
  - The capacity constraints led to an increase in the prices of drilling services and drove up investments into building up capacities
    - ⇒ The prices of drilling grew by the average of 10% in production drilling and by around 30% in prospecting and exploratory drilling. The latter segments increasingly become key areas of focus for independent drilling companies
    - ⇒ Orders for manufacturing of drilling equipment by state oil and gas companies increased
  - Growth in prices amid declining dollar led to opening market for foreign drilling contractors – the process that will continue to open market opportunities and increase competitiveness
  - Oil companies and key market players will be growing capacities at a fast pace
    - ⇒ Gazprom ordered 11 rigs from Uralmash drilling equipment
    - ⇒ Rosneft ordered 4 rigs from Uralmash Drilling Equipment with option to extend order by three additional rigs in 2009-2010, 2 rigs from Benteq and 2 rigs from the Volgograd Drilling Equipment Plant
    - ⇒ SSK bought 4 mobile drilling rigs from RG Petro-

drawdown in April 2008 against an agreed schedule for development of the Dulisminskoye field.

Urals Energy is now in a stronger position to continue its field development programme and has already delivered the first drilling rig to the field with a second rig due in April 2008. In addition, land has been cleared for drilling pads, infield roads and areas of the central field processing facilities and field camps. Urals Energy anticipates first oil from the field to flow into Transneft's East Siberia – Pacific Ocean pipeline in the first half of 2009.

*15 November 2007*

Machinery Cp., Ltd (China)

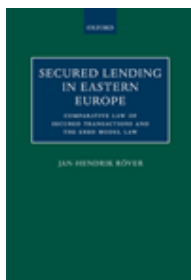
⇒ Drilling Company Eurasia placed orders for the total of 8 drilling rigs since the middle of 2006 (4 drilling rigs from Bentec, 2 from Le Tourneau Ellis Williams and 2 from Izhdril HunHua)

- The growth of spending on drilling will most likely put downward pressure on the prices for other oilfield services possessing excessive capacities
- The consolidation of assets and investment resources will drive up the price of oilfield service capacities available for consolidation

**3. OFS market will continue to grow at 15% per annum in nominal US dollar terms on average till 2015 if it is to achieve 2% per annum growth in output.**

- Russian OFS market as defined in the report may reach US\$ 36 billion in 2015
- The growth will be dominated by increased drilling activity, which will grow from 13 million meters in 2006 to forecasted 34 million meters in 2015. Incremental market provided by this activity will be in an order of US\$ 19 billion to 2006 levels
- All activities associated with drilling, such as logging, drill bits, cementing and completion services, will grow at the same fast pace
- Heavy workovers segment will provide for additional US\$ 3 billion in market size by 2015.

RPI is a research and advisory firm on the energy industry of Russia, CIS, the Caspian region and Central/Eastern Europe. To obtain additional information about the study please visit RPI web page <http://eng.rpi-inc.ru/publications/items/?p=34&fra=acp> or address Vsevolod Prosvirnin by phone: +7 (495) 967-0117 or via email: [Prosvirnin@rpi-inc.com](mailto:Prosvirnin@rpi-inc.com)

**Recent publications by Asset Capital Partners:****Jan-Hendrik Röver, Secured Lending in Eastern Europe. Comparative Law of Secured Transactions and the EBRD Model Law (Oxford 2007)**

This new work is the first comparative study of central and eastern European secured transactions laws to be written in English. It gives a valuable insight into the legal reforms taking place in the transition economies of central and eastern Europe (and elsewhere), by explaining the general mechanics of secured transactions law in a helpful and practical way.

The book explores the characteristics that make security law useful from a practical point of view, the purpose being not merely to describe existing rules on security but to concentrate on the question of how those rules can apply in practice. The author concentrates on seven central and eastern European secured transactions laws in Bulgaria, the Czech Republic, Hungary, Poland, Romania, the Russian Federation and the Slovak Republic. These laws are contrasted with the EBRD's Model Law on Secured Transactions and the EBRD's Core Principles for a Modern Secured Transactions Law. In addition, English, German and US law (which, among others, influenced the EBRD's work) are used as further reference sources.

The descriptions of eastern European laws were reviewed by Nörr Stiefenhofer Lutz, a leading European law firm, thus ensuring an up-to-date introduction to central and eastern European secured transactions laws.

**Asset Capital Partners** is an international investment banking and financial advisory firm based in Munich and Moscow with a special focus on Russia and other CIS countries.

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