



NEW HORIZONS

SALYM PETROLEUM DEVELOPMENT N. V.
QUARTERLY

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SALYM PETROLEUM



FIRST SMART WELLS
IN RUSSIA (P. 2)

West Salym Field Facilities

SALYM PROJECT MILESTONES

In the chronicle of the Salym fields development, 2005 was marked by intensive construction efforts, culminating in bringing on stream West Salym, the largest of the Salym fields in terms of reserves. 2005 saw the completion of the first train of the Central Processing Facility (CPF) with the capacity of handling three million tonnes of crude per year, the 88 km-long export pipeline to Yuzhny Balyk booster station, a facility for crude custody transfer into the Transneft system, five well pads, oil gathering networks, and other key infrastructure facilities. The completion and commissioning of these facilities and their integration into a single system have opened the way for a quick ramp-up of oil production.

Increasing oil production volumes has been a priority for Salym Petroleum Development (SPD) in 2006. The results of the first half of 2006 demonstrate that the challenge has been met. In December 2005, daily production from the two producing fields, Upper Salym and West Salym, was 13,300 bbl/d. By the end of April, 2006 it exceeded 40,000 bbl/d, and reached 51,000 bbl/d at mid-year.

This impressive production growth has been made possible by faster drilling and the completion of new wells in West Salym. During the first 6 months of 2006, 49 wells have been drilled and 48 wells brought on stream. The average well drilling time in SPD is 12-13 days, which is much better than the average for West Siberia (18-20 days). SPD set a record by drilling a well in 8.1 days, a source of pride for the company and its two drilling contractors: the Siberian Service Company and KCA Deutag.

In another outstanding development during the first half-year, SPD pioneered an exploration well in West Salym to test the production potential of the Achimov formation, which lies at a depth of 2,700-2,800 m. The formation will be hydrofractured and production tested. If the testing proves positive, SPD will have additional opportunities to increase production.

The construction of field facilities continued in Salym during the half-year. A formation pressure maintenance system was completed in West Salym. The construction of a 36-km multiphase oil

pipeline connecting Upper Salym and West Salym is nearing completion. Once put into operation at the end of this summer, the pipeline will transport Upper Salym oil to the CPF at West Salym.

The Vadelyp field will later be tied-in to the multiphase oil pipeline. The first well pad has recently been completed, and one of the four West Salym drilling rigs has been moved there to spud the first development well at the end of June. SPD expects to produce the first oil from Vadelyp this coming autumn.

Very soon the crude oil from the three Salym fields will flow to the CPF at West Salym and then go into the Transneft system. To increase its throughput, the commissioning of the second train of CPF with an additional capacity of three million tonnes of crude per year is under way.

Considering the oil production growth already achieved by SPD in the first half of 2006, it will confidently meet its oil production target set in the project documents for this year, i.e. produce more than 15 millions barrels of oil from the three Salym fields. ■

SPD AT MIOGE-2006

SPD took part in the regular MIOGE-2006 international oil and gas exhibition, which took place on June 19 – 23, 2006 in Moscow. At its stand, SPD offered various information materials and ran a movie devoted to the implementation of the Salym Project. The stand offered an opportunity for people in the oil industry to meet their SPD counterparts, gain first-hand information on the development of the Salym group of fields, exchange experience, and discuss the latest events in the Russian and international oil industry.



SPD AND OAO TMK SIGN STRATEGIC PARTNERSHIP AGREEMENT

On June 23, 2006 Salym Petroleum Development and OAO TMK signed a Strategic Partnership Agreement for three years. The Agreement contemplates supplies by TMK for SPD of oil casing and tubing goods for drilling and production as well as line pipes for infield pipelines construction, and covers the period of 2007-2009 with options to extend.

OPEN FORUM IN SALYM

A regular Open Forum took place on April 20, 2006 in Polar Lights community center in the Salym village. The purpose of this SPD-organised annual event is to update the public on the status of the Salym oilfields development and SPD's involvement in the region's social projects, and share plans for the near future. Top managers of SPD, officials of the district and local administrations, Salym residents, and the regional media attended the event.



SPD-SPONSORED TRAINING COURSE TURNS OUT FIRST GRADUATES

The SPD-sponsored professional training program for young people from Salym and neighboring areas has reached its first milestone, with the first 19 students graduating. During a year, the nineteen young people who had been selected on a competitive basis learned the theory of oil and gas production at the training center in Pyt Yakh and received on-the-job training at the production facilities of the Salym Project. SPD financed all training costs and paid educational allowance to the students. Upon completing the course, the graduates received state certificates, which will allow them to work in their new specialty at oil and gas production companies of Russia. Ten best students had been offered jobs in SPD and they have already joined the Company. Selection is now in process to make up the next group of students, who will start their studies in September this year.



FIRST SMART WELLS IN RUSSIA

ONE OF THE ADVANTAGES OF SPD AS A JOINT VENTURE COMPANY WITH FOREIGN CAPITAL IS THE POSSIBILITY TO HAVE ACCESS TO THE STATE-OF-THE-ART TECHNOLOGIES TESTED ELSEWHERE BY OIL PRODUCING COMPANIES OF SHELL, WHICH IS ONE OF THE FOUNDERS AND SHAREHOLDERS OF SPD. THE COMPANY IS GOING TO MAKE USE OF THIS POSSIBILITY IN THE DEVELOPMENT OF VADELYP FIELD. THIS COMING AUTUMN SPD WILL START CONSTRUCTION OF SMART WELLS AT VADELYP, THE FIRST SMART WELLS IN RUSSIA. DAVID GARDINER, A PRODUCTION TECHNOLOGIST WITH SPD, EXPLAINS:

What Are Smart Wells?

Smart wells are where equipment is installed downhole to measure real time data at surface and allow control of flow from or injection into different intervals. Standard wells cannot achieve this and infrequent measurements are required with data gathering and control only by well intervention or expensive workovers, which results in oil deferment and downtime.

By using and adjusting downhole equipment from surface, SPD will be able to combine production from different reservoir intervals in the same well. This will also allow measurement of flow from each interval and when necessary the ability to open and close production per interval to minimise water production or interference between zones.

The main equipment devices used are downhole flowmeters and downhole interval control valves, which can then transmit data to surface or be operated from surface.

Example smart well planned in Salym with flowmeters and downhole control valves is shown in the Fig.1.

Why SPD Is Using Smart Wells in Vadelyp

In the Vadelyp field it is planned to produce from several reservoirs. The reservoir engineers need to understand how much production is coming from each reservoir so that predictions can be made about future oil recovery and the field properly managed. The field operations staff need to monitor and allocate production to different reservoirs to optimize production and to comply with statutory requirements. Without smart wells it would be necessary to drill separate wells into each reservoir to get

the same data gathering and control. This will also bring both environmental and economic advantages as fewer well pads and roads will have to be constructed.

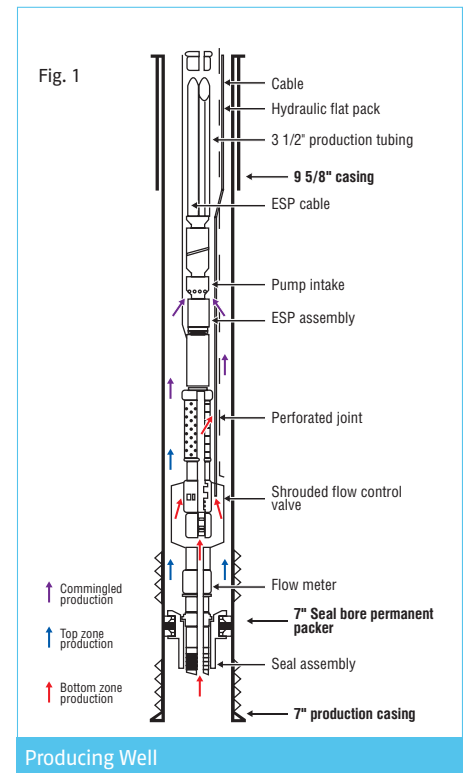
Since smart wells are new to Russia, SPD will start using downhole flowmeters in the first few Vadelyp wells with control by intervention and then introduce downhole control valves in the later stages. Once proven in Vadelyp, then smart wells could be applied in other Salym fields to allow monitoring and control of production from the different reservoirs, and help optimize well production and improve the ultimate recovery through better control of the sweep in the reservoir.

Ultimately, SPD will move to three zone producer completions measuring flow from each zone and controlling production per interval from surface. Similarly for water injectors SPD will be able to measure injection into each reservoir interval and control where the water is being injected to maximize oil recovery.

The Future — Smart Fields

The Smart Well project is an important part of a potential larger Smart Fields initiative in SPD. The term "Smart Fields" describes the manner through which SPD aims to maximize the lifecycle value of an asset, such as Vadelyp, through continuous optimization of all its components: wells, reservoirs, pipelines, and facilities. Smart Fields is about the ability to measure and control and its principle is captured in the Smart Fields Value Loop (Fig.2).

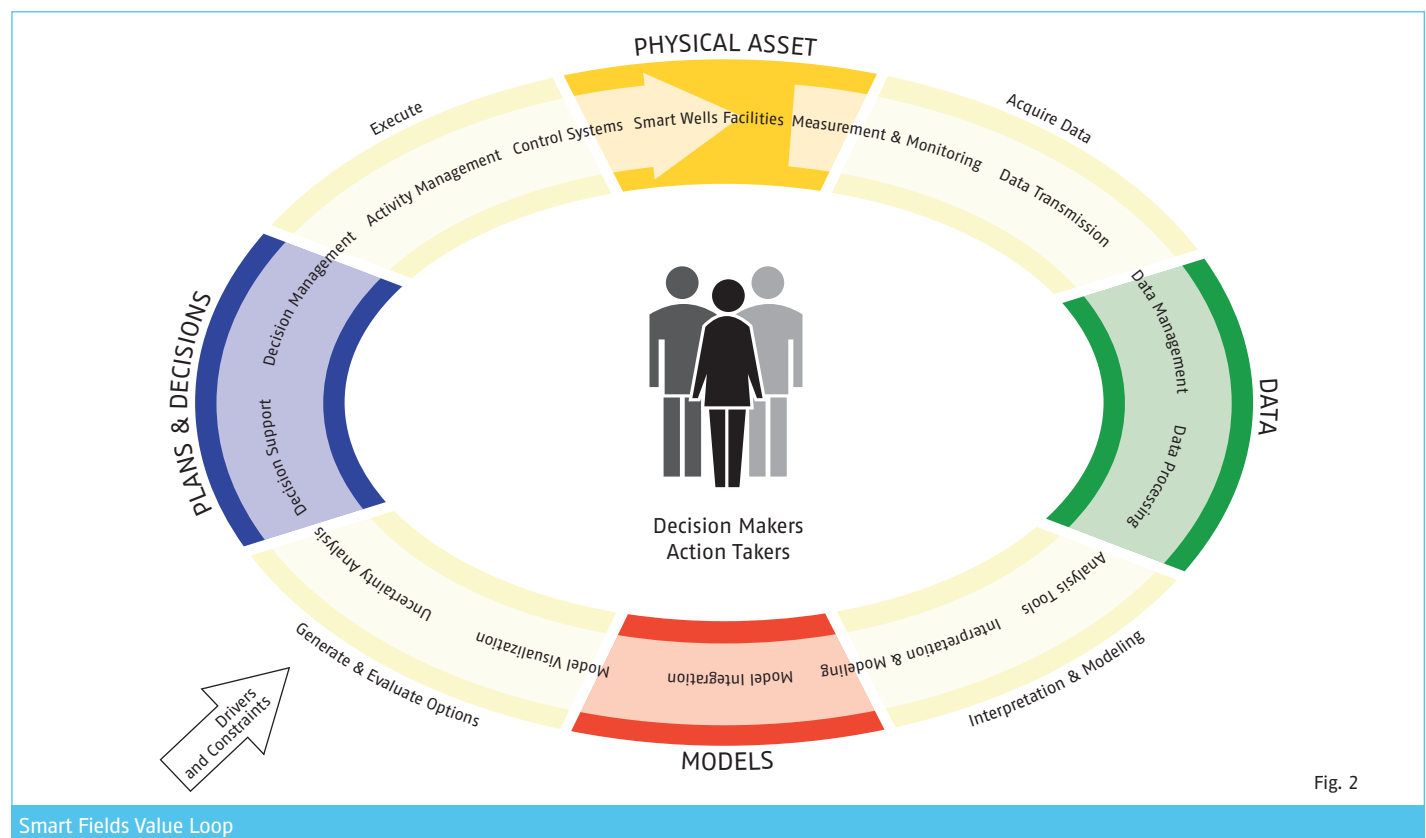
This value loop is applied by assessing the key decisions, which are to be made to optimize life cycle value. The measurements from the wells and facilities (e.g. pressure, zonal flow rates, composition, temperature) are stored and processed as data are fed



Producing Well

into real time models (subsurface, well inflow and outflow, surface facilities models) that can be used to understand the current and future behavior of the wells and reservoirs.

Subsequently, these models can be used to generate and evaluate options to improve this behavior with respect to the project's drivers and constraints and make decisions on the optimum setting of the integrated production system. When smart fields technology is applied correctly, these options will result in a reduction in life cycle cost, optimized production, and increased recovery. Smart wells, as the key link to the reservoirs, are instrumental to achieve this kind of smart development of a field. ■



Smart Fields Value Loop

Fig. 2

IRON SHARPENING IRON

CLOSE COLLABORATION BETWEEN SALYM PETROLEUM DEVELOPMENT AND SIBBURMASH, A MAJOR RUSSIAN CORING COMPANY, HAS LED TO DRAMATIC IMPROVEMENTS IN BOTH COMPANIES' PERFORMANCE.



Coring in Progress

With help from SPD, SibBurMash has succeeded in running core barrels 36 m long while continuing to bring to surface top quality core with 100% recovery. That length, a record for SibBurMash, is far above the average Russian barrel of 6 m to 12 m, and it has helped reduce by more than 50% SPD's coring time in the Salym fields.

"The relationship has been a typical win-win situation," says Gilles De Broucker, leader of the subsurface field team at Salym and coring contract representative.

"It shows how a local company can benefit from the collaboration with SPD and Shell. In this case, we were able to persuade SibBurMash to try ever longer coring barrels, a feat that we were confident could be accomplished because of our global experience with long barrels in other drilling environments."

"At first glance, the requirements of SPD seemed unusually stringent," says Bulat Khairullin, general manager of SibBurMash. "But we came to see them not

so much as stringent requirements, but as high standards. SPD's high expectations stimulated the creativity of our designers. As a result, after beginning from cores of 6 m, today we already have achieved cores of 36 m in one descent, and the coring speed has grown nearly fourfold, from 1.96 m/h to 7.93 m/h on average."

In the process of collaboration SibBurMash team came to see that, while SPD expects much, it provides much as well. "I can't say enough about the professionalism of the international team at SPD," says Khairullin. "Whether at base camp, in Tyumen, or in Moscow, SPD people are always attentive and kind, and above all willing to help and train our people – as for example when they sent a Shell core expert to Tyumen to talk to us about the impact of longer barrels on core analysis quality.

"This experience has been so satisfying because it goes straight to the heart of what SPD is doing here in Siberia," De Broucker says. "The best of advanced technologies from around the world meeting the best of Russia: it's our goal, and it is working at Salym."

According to Khairullin, the benefits of SibBurMash's new expertise, acquired in the partnership with SPD at the Salym fields, will quickly radiate out into the Russian market. That's because SibBurMash is present in the major hydrocarbon-producing regions of Russia. SibBurMash is now in a position to use the longer barrels, which provide more complete geological information about the properties of the rocks, in its activities elsewhere. ■

MEDIA PEOPLE TOUR THE SALYM FIELDS



Russian and foreign media visited the Salym group of fields on May 23-25, 2006 in a tour arranged by SPD on a regular basis since 2004. This year, the tour attracted more than 30 news and photo journalists from regional, national, and foreign newspapers, oil and gas publications, news agencies, and TV companies. A press conference was held during the media tour, with SPD represented by CEO Dale Rollins, deputy technical manager Shuan Baban, well engineering manager Koos Koole, external affairs director Elena Zakupneva, and field manager Joe Diamond.

GAS TURBINE POWER PLANT AT WEST SALYM



The Supervisory Board of SPD has approved the construction of a \$54.9 million Gas Turbine Power Plant at the Salym group of oilfields, with \$20.4 million to be committed for preparatory works in 2006.

A 45 MW Gas Turbine Power Plant will be built at West Salym, the largest of the Salym group of oilfields and will generate electric power by utilizing associated gas. The facility is scheduled to come into operation at the end of 2007.

"The construction of Gas Turbine Power Plant will allow SPD to ensure stability of energy supplies for the Salym Project field infrastructure facilities, reduce future operational costs and realize efficient use of produced associated gas," commented SPD CEO Dale Rollins. – "This is a major step forward in implementation of our program of associated gas utilisation. By 2008, SPD plans to stop continuous flaring and thereby improve environmental parameters in the area of operations."

TAKING CARE OF THE ENVIRONMENT

ENVIRONMENTAL PROTECTION IS ONE OF THE KEY ELEMENTS OF THE SALYM DEVELOPMENT PROGRAM OF SPD. ECOLOGICAL PROGRAMS AND PROJECTS OF THE COMPANY FOLLOW THE REQUIREMENTS OF THE RUSSIAN ENVIRONMENTAL PROTECTION LAWS AND STANDARDS OF SHELL, ONE OF THE SHAREHOLDERS OF SPD. LEADER OF THE ENVIRONMENTAL GROUP IGOR KOLTISOV SPEAKS ABOUT SPD'S PRIORITY ENVIRONMENTAL CONSERVATION PROJECTS IN 2006:

As the scope of operations and oil production grow, so do the potential threats to the natural environment.

Oil spills are one of our greatest threats. To address the potential problem, SPD has developed a comprehensive plan of eliminating oil spills, which has been approved by the respective government authorities. We have manned and equipped a dedicated emergency response team and have ordered additional equipment and machinery for them. There is also a contract in place with a specialized emergency and rescue unit of Siberian Rescue Center, which will be available to bolster our resources in case of need. This year, we have and continue to train personnel in oil spill containment and removal, and will hold a special exercise to test the coordinated actions of all services that need to be involved in oil spill emergency response measures.

Preventing contamination of the environment by industrial and domestic waste,

and utilization of associated gas is another important element of our activity. In 2006, we started the construction of the first phase of the waste disposal facility to accumulate and utilize industrial and domestic waste. The waste disposal facility will store and process oil sludge and contaminated soil and compost and bury domestic waste.

To utilize associated gas, a gas turbine power plant will be built, which will burn most of such gas and produce electricity. SPD and Shell are evaluating other solutions to improve the utilization of associated gas. In particular, the companies are looking at the possibility of injecting the gas back into the formation, building a pipeline to a gas processing plant or trunk line, and using gas to enhance oil recovery.

Air and soil, surface and ground water are regularly monitored on the territory of the Salym group of fields and export pipeline right-of-way, with the measurements checked against background data. The main purpose of



Emergency Response Practice

such environmental monitoring is to make sure that our operations do not affect the natural environment in a harmful way.

As required by the Shell biodiversity standard, SPD started a comprehensive study of the flora and fauna in the area of the Salym fields in 2006. Researchers from the local Surgut State University, which have studied local nature for many years, have been invited to participate in the effort. The public will be regularly informed about the results of the study, which will continue throughout 2007. ■

GRADUATES OF SALYM HIGH SCHOOLS RECEIVE SPD GRANTS

SPD has launched a new educational project in Saly. At an open public forum in April 2006 the Company announced that it would finance grants for graduates of Saly high schools to pay for the tuition at higher educational establishments of the Urals Federal District. SPD plans to provide five grants every year to finance a complete course of studies at



Urals colleges and universities. The grants will be awarded on a competitive basis, the candidates required to produce a presentation on their future specialty, which would then be judged by a jury panel. The first five winners of the grants were selected on May 25, 2006, and their names made public at an official ceremony in Saly. SPD has invited the five winners to Moscow, where it has arranged for them a sightseeing tour and a visit to the Company's Moscow office.

SUPPORTING SMALL BUSINESS

SPD has completed the first stage of its program to support small businesses in Saly village. As part of the preparations, SPD contracted the New Eurasia fund to make a comprehensive study of the status, possibilities, and prospects for the development of small businesses in the region. Based on the results of the study, the Company will decide how to best structure and finance the support programs for small businesses to diversify the local economy and create jobs. At this stage, SPD considers extending credits as one of the main vehicles of support for such companies. The details of the credit arrangements are to be worked out in the immediate future.



BORN IN 1965

EDUCATION:
M.Sc. Offshore Engineering, MBA, Chartered Mechanical Engineer

MARRIED,
has two small daughters

HOBBIES:
fast cars, music, and history

SALYM CHILDREN GO FOR ENVIRONMENTAL SCIENCE

FOLLOWING A SOCIAL AND ENVIRONMENTAL IMPACT ASSESSMENT OF THE SALYM DEVELOPMENT IN 2003, SPD STARTED A DIALOG WITH THE LOCAL AUTHORITIES AND COMMUNITIES THAT HELPED SET PRIORITIES FOR SPD'S INVOLVEMENT IN THE SALYM'S SOCIAL PROGRAMS. THE PROGRAM INCLUDES: DEVELOPMENT OF HEALTH CARE, SCHOOL AND PRE-SCHOOL EDUCATION, THE VILLAGE SOCIAL INFRASTRUCTURE, AND SMALL BUSINESSES. IN THIS ISSUE WE PRESENT A FEATURE ABOUT SPD'S SUPPORT OF ONE OF THE PROJECTS IN SCHOOL EDUCATION.

They work in Muraveynik (Ant Hill), a forestry research center for children, which operates on the premises of the Saly forestry. The training center has been around for several years, and from the very start has been led by Valentina Parfinenko. The future environmentalists study the water, air, and soil at the 200 hectares of land allocated by the Saly forestry to the center. Conducting research in the forest requires special techniques, clothes, and protective equipment. Last year, the children got everything they needed for their work, including books and office equipment, from SPD. To support the creative endeavors of the children, the Company funded the purchase of a research laboratory for the center. The kids are now fully equipped to do more types of research studies with more fun.

Says Valentina Parfinenko: "We felt handicapped, because we did not have an opportunity to visit outside of our research area, and did not have the resources to take part in workshops and conferences." Well, that has changed. SPD has financed two educational trips for the children. In the summer, they went to Yekaterinburg, where they visited the Forest Engineering School, the Urals State Forest Engineering University, and the local botanical gardens.

Last autumn, they participated in the Friends of Protected Areas Forum in Moscow, where they presented two



Forest Research

environmental projects. "Environmental passports" have now been attached to both projects as a sign of their official status. The focus of their research work, started in 1997, continues to be the study and analysis of the environmental impacts of industrial

activity. In a couple of years, the children from Muraveynik forestry research center will graduate from school and some of them may embark on an ecologist career and, perhaps, at a later stage join the environmental team of SPD. ■

Company and People

SINCE 2003, WHEN THE SALYM OILFIELDS DEVELOPMENT ENTERED INTO ITS INTENSIVE PHASE, SPD HAS GROWN FROM A 15 STAFF ORGANIZATION TO A MAJOR OIL PRODUCING COMPANY WITH OVER 850 EMPLOYEES. MOST OF THESE (OVER 90%) ARE RUSSIAN CITIZENS. THERE ARE ALSO EXPATS REPRESENTING 14 NATIONS. IN THIS ISSUE WE WOULD LIKE YOU TO MEET ONE OF EXPATS WORKING FOR SPD. SHUAN BABAN COMES FROM GREAT BRITAIN WHERE HIS PARENTS MOVED WHEN HE WAS SEVEN. SINCE 1993 SHUAN HAS BEEN WORKING ON VARIOUS PROJECTS IN RUSSIA. IN TYUMEN HE MET HIS FUTURE SPOUSE.

Q.: What did you do before joining the Saly Project?

A.: I have worked for a Russian oil major and various EPC contractors and I also have three year offshore experience in the North Sea.

Q.: Could you describe briefly what is your current role in SPD?

A.: I am deputy technical manager, my responsibilities include supporting/organizing the construction and commissioning of key field facilities and liaising with government authorities.

Q.: How does SPD project differ from others you've been engaged in?

A.: It is different in terms of greater trust from senior management, a serious attitude to the HSSE (Health, Safety, Security, and Environment) issues and fair treatment of employees.

Q.: What is your best impression of interfacing with SPD contractors?

A.: The most enjoyable moment is when our contractors realize that what many see as impossible is attainable and that with the right approach and attitude they, along with SPD, can successfully

deliver complex projects on time.

Q.: What are your relationships with the people who work under your supervision?

A.: I may not appear to be but I am quite an approachable person and always willing to consider any comments and opinions and very willing to help out and/or advise where I can. Those that know me well often provide me with positive and/or negative feedback, which I try to take into consideration in any future actions.

Q.: What are your hobbies? What puts you in the good mood?

A.: Speed! When I go on holiday, I like to drive fast cars such as Ferraris and Porsches, though a Porsche is more to my liking...

Q.: What else do you fancy?

A.: I like rock and classical music and have a huge collection of recordings. When I want to get a bit of "get up and go" I would listen to The Sisters of Mercy or Placebo and if I want to relax I switch to Pink Floyd, Matt Bianco, or classical music. Recently, I have come to enjoy reading history books. ■

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