

By Lord Robertson of Port Ellen



# TNK-BP: A RUSSIAN SUCCESS STORY

**TNK-BP has been a major success story in Russia, since it was formed in August 2003. The company has had the best performance in the Russian oil industry on virtually every key measure over the past five years. It has been good for Russia, and good for both of its key shareholders — BP and Alfa Access Renova (AAR). TNK-BP has delivered the highest rate of organic growth in oil production of any major Russian oil company. It has led on reserve replacement too, with the highest organic average reserve replacement ratio of any major Russian oil company. This reflects the benefits of the transfer of world class technology, capability and people by BP to Russia.**

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Since 2003, the shareholders BP and AAR have shared dividends in excess of \$20 billion, more than any other Russian company we know of. In addition, the company has paid more than \$80 billion in taxes and duties to the Russian Federation.

The past year has seen a very public spat between BP and AAR, TNK-BP's two sets of shareholders about the company's future. However in September the two sides agreed a memorandum of understanding to change the board structure, to appoint a new chief executive and to consider an initial public offering of TNK-BP shares.

Announcing the agreement, BP's chief executive Tony Hayward praised TNK-BP's outgoing chief executive Robert Dudley as "an absolutely outstanding CEO of great courage and strength of character."

As the company enters a new phase in its development, it is worth reflecting on what has actually been achieved over the past five years.

When the JV (Joint Venture) was established, BP made four promises to the Russian Federation:-

- that TNK-BP would grow production and reserves,
- that we would transfer our best technology and people into the JV,
- that we would improve corporate governance,
- that we would be a good corporate citizen of Russia.

We have delivered on all of these promises; we have also made huge strides in health and safety, the environment, governance and transparency.

Making good the first of those promises crude oil production grew 26%, reserves (net of acquisitions and disposals) and reserves have been replaced at an annual average rate of 138%. In addition TNK-BP has recorded the lowest (\$2.20 per barrel) average finding and development costs among Russian oil companies.

In its first five years TNK-BP has achieved the highest average annual return on capital employed (35%) among major Russian oil companies and the highest (45% a year) total shareholder return of any major Russian oil company. Refining and marketing earnings have risen fivefold in five years.

Structurally the company has been transformed. Five years ago TNK-BP consisted of some 600 loosely-connected subsidiaries employing around 100,000 people. It is now down to about 400 subsidiaries and 65,000 employees.

It ranks as Russia's third largest producer with output of 1.6 million (boed) barrels of oil equivalent a day, accounting for 18% of the country's total production. It meets 5% of Europe's oil demand and qualifies as one

of the world's ten privately-owned oil and gas companies in the world.

Reflecting on these ground-breaking developments TNK-BP chairman, Mikhail Friedman, said: "I am proud of what TNK-BP has already achieved."

To achieve those results, capital expenditure has been increased from \$800 million in 2003 to more than \$4.4 billion this year — a 450% rise. This massive investment programme has boosted recoverable reserves and created a portfolio of 14 new greenfield projects led by Uvat and Verkhnechonskoye but also revived many ageing Soviet-era oil fields, such as the Samatlor field in West Siberia, one of the world's largest oilfields.

Discovered in the 1960s, Samatlor's production peaked at nearly 3.2mn b/d in 1980, but by 2003 had become a declining asset in need of repair and renovation. Following a study by company technicians, new technologies have been introduced since 2005 to improve well performance as well as reactivating idle wells and using 3D seismic data to identify and drill additional locations within and around the field.

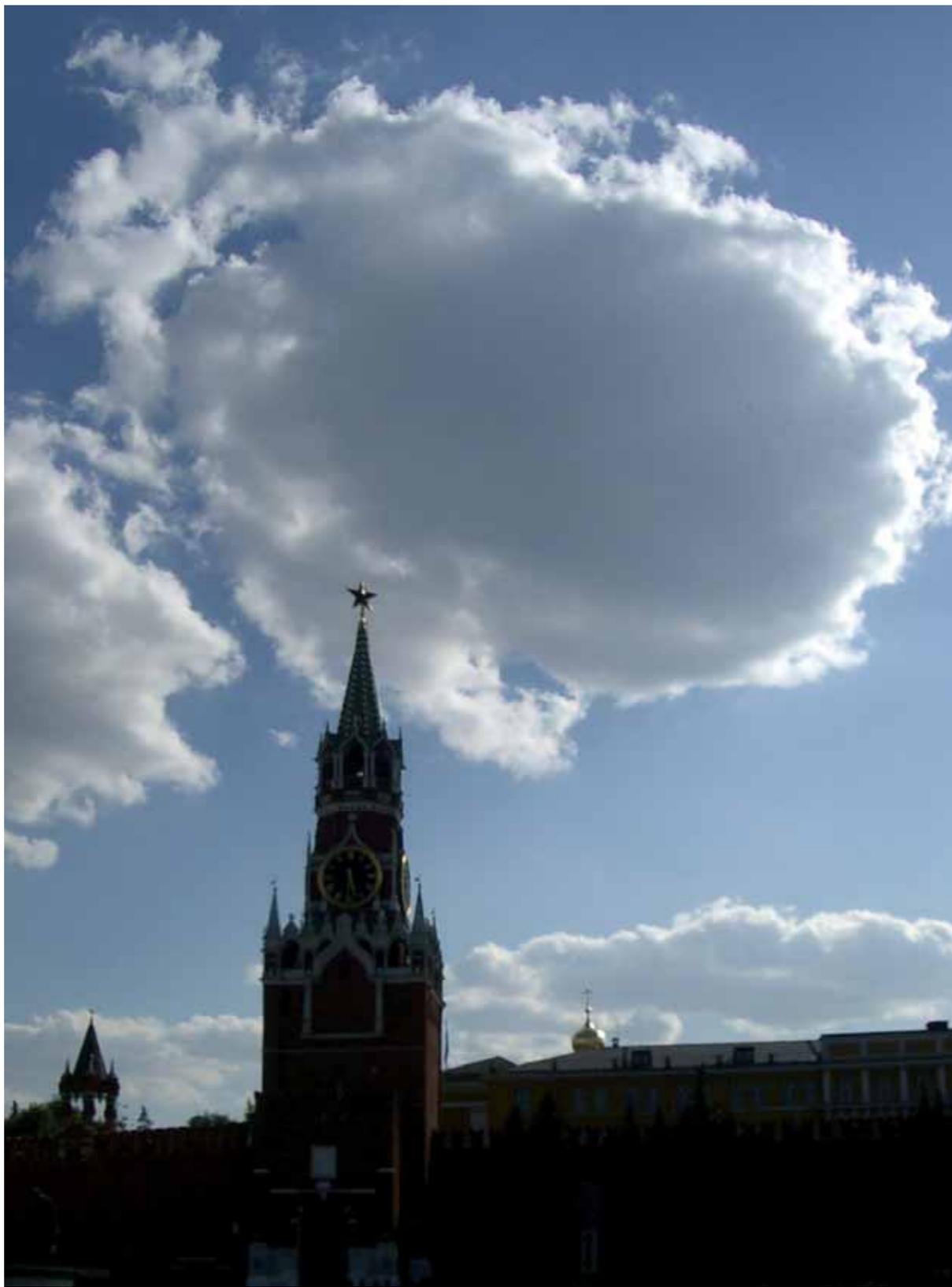
As a result, daily output has risen by nearly one-third to around 600,000 b/d this year. This is expected to stay steady through 2012 and the company believes that Samatlor can continue to produce for many more decades.

This optimism is based on some hugely successful 3D seismic as well as hi-tech extended reach drilling. This has proved seven satellite structures, most of which are now being developed. In addition, another nine satellite structures have been identified and more are being tested.

Employing some 18,000 people Samatlor is hugely important for the region. In keeping with promises to improve the company's environmental record, drilling waste from the Samatlor field that used to be dumped in pits and left, is now supplied to a local brick-making facility. Some 1,700 hectares of oil-affected land has been cleaned up and returned to the local government for use.

TNK-BP has also made great strides in capturing gas and reducing gas flaring as part of a plan to meet government targets to better utilize this important energy resource by 2011. Next year the company expects to fulfil its commitment made five years ago to cut pipeline leaks by half. So far more than \$600 million has been invested in an integrity management programme using leading edge corrosion inhibition technology.

But the changes are not just about equipment and statistics. TNK-BP has become a much safer place to work. A major programme to reduce accidents through



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training and safety awareness has also borne positive results. Work-related injuries are down by more than one third as a result of improved risk-management skills and greater awareness among employees.

Staff and managers are encouraged to improve their skills through training. More than 177,000 man-days of training have been delivered in the last five years to improve leadership and to enhance individual skills at all levels.

Management practices have been modernised to give TNK-BP a leading edge in many areas of activity. For example, improvements to supply-chain management have been introduced to boost efficiency. With annual spending of several billion dollars and some 20,000 contracts to be controlled and kept track of it is vital that the planning and organisation of all activities involved in sourcing, procuring and supplying all sorts of goods and services needed by the company

are done as efficiently as possible. Performance-related long term contracts have replaced mostly annual, fixed price contracts. This has reduced by about two thirds the average time taken to buy materials and equipment.

One area of change may bring long-term benefits, especially if the company agrees to go ahead with an IPO. The introduction of international accounting standards has improved transparency and accountability at every level. At the same time internal best practices in many areas including operational performance and corporate responsibility have been introduced widely in the company.

Russia itself has been the greatest beneficiary of this transformation. The Russian government has earned more than \$80 billion in tax revenues, excise and duties from the company's activities. Many ageing oilfields including Samatlor have been given a new lease of life.

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As well as the giant strides taken in exploration and production, the refining and marketing sector has also been heavily upgraded. TNK-BP's four refineries have been modernised and now operate at close to international quality levels. They produce cleaner products, including low sulphur gas oil and BP Ultimate gasoline and diesel for export and the local market.

Social programmes to preserve Russia's cultural heritage and to promote healthier lifestyles have benefited from more than \$300 million in social programmes. Within the company, about two thousand employees of TNK-BP Management (65% of the total) have been promoted. And a few hundred have been on secondment and training programmes with BP outside Russia, enabling them to learn the most modern techniques and skills.

Recognising this success story Igor Sechin, Russia's first deputy prime minister and chairman of Rosneft, the state-controlled Russian oil company said in July. "Overall, we support the work of BP in Russia. They have introduced new corporate governance principles, technology, personnel training and transparency — all of which makes us very happy."

As it builds on this strong legacy under new leadership TNK-BP hopes to continue to expand oil production and to improve refinery efficiency. It will continue to seek and compete for new opportunities around the country and perhaps to expand into new areas such as gas-fired power generation. It will continue to look abroad for new business to add to the opportunities it is pursuing in Kazakhstan, Venezuela and Turkmenistan.

Following the agreement this summer Tony Hayward said "BP is committed to Russia in the long term. On every criterion — safety, people or financial and operating performance — this has been a very successful partnership. We are delivering on our promises." He added, BP will "have less of a footprint in the company" in future although a shareholder agreement subject to English law and the same principles agreed in 2003 will remain in place. ■

**Lord Robertson of Port Ellen is Deputy Chairman of TNK-BP and Chairman of its Audit Committee. He is the former Secretary General of NATO and Defence Secretary of the UK. He is Co-Chairman of the UK/Russia Round Table**