



## **Sakhalin Energy Investment Company Ltd.**

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### ***Press Release***

## **Sakhalin Energy signs its third LNG supply deal with Kyushu Electric**

Yuzhno Sakhalinsk, Russian Federation, 24 July 2003: The multi-billion dollar Sakhalin II Phase 2 Project achieved another major marketing success today with the signing of a substantial liquefied natural gas (LNG) supply agreement between Sakhalin Energy Investment Company Ltd. and Kyushu Electric Power Company, Incorporated. The deal calls for the supply of up to 0.5 million tonnes per year for a period of some 21 years.

The sales deal with Kyushu Electric is the third successful deal signed with a major utility company in Japan, which reinforces Sakhalin Energy's firm position as a major new supplier of LNG to the Japanese market. Since the Company's formal Declaration of Development Date for the Lunskoye gas and condensate field this May 2003 - which launched the Phase 2 development of the Sakhalin II Project - the momentum of the project has also been accelerating on the marketing front. This deal brings volumes of natural gas sold from the Sakhalin II Project to more than 2.8 million tonnes per annum for periods in excess of 20 years.

This LNG sales agreement further reinforces Sakhalin Island as the new strategic source of natural gas for Japan, and confirms the wider Asia Pacific Region as a major new market for Russian gas supplies. It also represents the beginning of Russia and Sakhalin Energy as major new players in the worldwide LNG market.

Steve McVeigh, Chief Executive Officer, signed the Heads of Agreement (HoA) on behalf of Sakhalin Energy, and President Shingo Matsuo, for Kyushu Electric. The long-term supply of LNG will begin with first deliveries expected in 2010. The two companies will now continue negotiations to enable a full sale and purchase agreement (SPA).

"This latest deal with Kyushu Electric from the southern main region of Japan represents a growing chain of commitments from Japan. It is a tribute to both the Sakhalin II project and the Russian Far East that customers are confident and are keen to tap the abundant gas supplies from Sakhalin, which represents the closest possible available supply source to Japan," said Sakhalin Energy Chief Executive Officer Steve McVeigh.

"We are extremely pleased that Kyushu Electric has become one of our foundation customers, and a leader in opening up this new strategic far eastern gas supply source.

With our strength in terms of capacity and proximity, we shall work in cooperation with Kyushu Electric to establish a strong relationship between us and become their preferred supplier,” added Steve McVeigh.

The LNG market is fiercely competitive at the moment. There are many other suppliers competing for business, coupled with uncertainties over deregulation and slow economic growth in the region. However, the Kyushu Electric agreement again indicates that a strategic and competitive supply source will bring success for Russia and Sakhalin Energy in the LNG business despite these tough conditions.

Steve McVeigh added, “This agreement with Kyushu Electric keeps our successful momentum in the marketing effort moving forward, and means that we have now pre-sold a significant part of the first train. We will continue the effort and expect further announcements of success in the near future as negotiations progress and mature over the remaining volumes from the plant. Sakhalin Energy believes that its strategic and competitive positioning will overcome challenges posed by today’s tough market.”

LNG will be supplied from Sakhalin Energy’s major new LNG plant, which is planned for construction at Prigorodnoye on the southern tip of Sakhalin. Front-end engineering design work on the plant has been completed, and full construction activities on the plant are expected to commence shortly following final approvals from the Russian Government. The LNG plant is a major part of the Sakhalin II Phase 2 project. It is the first LNG plant to be built in Russia and will have a total capacity of 9.6 million tonnes per annum (mtpa). The plant will have two gas liquefaction process trains, each with a capacity of 4.8 mtpa – currently the largest LNG trains planned in the world.

The oil and gas resources located offshore of Sakhalin are world-class in size and quality, and in the future there is a possibility for the Sakhalin II facilities to be expanded to accommodate additional hydrocarbon export capacity from other projects, thereby becoming a “Corridor to the marketplace”.

Sakhalin Oblast Governor Igor Farkhutdinov commented: “With the commitment from Kyushu Electric, we are pleased that our very close neighbor continues to confirm their interest in Sakhalin as a strategic and reliable supplier of natural gas to Japan. It is a great pleasure to share the development of this world class project with Kyushu Electric. Sakhalin will become even more attractive not only as a source of energy supply but as a partner of Japan through strong and long-term relationships.

Mr. Shingo Matsuo, President of Kyushu Electric, commented, “We recognise the importance of Sakhalin as a close, competitive and flexible supplier of liquefied natural gas for the future.”

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## Notes for editors

Sakhalin Energy Investment Company Ltd. is an incorporated company, established in April 1994 and based in Yuzhno-Sakhalinsk, Russia for the purpose of the implementation of and development of the Sakhalin-II integrated oil and gas project. The shareholders in Sakhalin Energy are: Shell Sakhalin Holdings B.V. with 55 % interest (parent company – Royal Dutch/Shell), Mitsui Sakhalin Holdings B.V. with 25% (parent company – Mitsui & Co., Ltd.) and Diamond Gas Sakhalin B.V. with 20 % (parent company – Mitsubishi Corporation).

The Sakhalin II development represents the largest single foreign direct investment project underway in Russia at the moment. It is the first Production Sharing Agreement (PSA) to be signed in Russia and the first PSA to go into operation following commencement of oil production under Phase I of the Sakhalin II Project.

Phase I has been successfully producing oil from the Vityaz Complex offshore Sakhalin since July 1999. The Vityaz complex consists of the Molikpaq production platform, a single anchor leg mooring buoy and the Okha floating storage and offloading unit, and is located on the on Astokh feature of the Piltun Astokhskoye (PA) reservoir offshore Sakhalin. The Molikpaq is the first offshore oil production platform in the Russian Federation.

Production is currently limited to the ice-free period during the summer months. Production during the 2002 season amounted to 10.8 million barrels, which has been exported to customers in Japan, China, and Korea.

Target crude oil production this season is 9.7 million barrels – about 70,000 b/d. The reduction in volume over previous seasons is due to natural pressure reduction in the reservoir. A pressure maintenance project (PMP) is currently underway to boost production back up to early production levels of 90,000 b/d using water injections to re-pressurise the reservoir.

The PMP calls for the installation of new water injection and power generation modules on the Molikpaq this summer at a total cost of about \$500 million. The PMP modules have been built by Amur Shipyard in Khomsomolsk, and represent the first work of their type that has been undertaken by the Russian Far Eastern shipyard. The new PMP modules were installed on the Molikpaq platform earlier this month, and hook-up and testing of the PMP facilities are expected to be completed by the end of the year in time for the 2004 production season.

Phase 2 of the Sakhalin II Project is thought to be the biggest single integrated oil and gas project ever undertaken, and gained its first gas deal when Sakhalin Energy signed Heads of Agreement with Tokyo Gas on 12 May 2003 for up to 1.1 mtpa of LNG over about 24 years. The second Heads of Agreement was signed with Tokyo Electric on 19 May 2003, with volumes up to 1.2 mtpa of LNG for a period of some 22 years. With the most recent deal with Kyushu Electric for up to 0.5 mtpa over 21 years, the amount of firm volume sold so far has reached 2.8 mtpa.

Phase 2 calls for the further development of the PA field – an oil reservoir with associated gas – and the development of the Lunskeye field – a gas reservoir with

associated condensate. Apart from the LNG plant, the project also calls for a new oil and gas production platform on the PA field, a new gas platform on the Lunskeye field.

An onshore processing facility will be built to separate gas and condensate from the Lunskeye field. More than 800 kms of pipelines will transport the oil and gas to an oil export terminal and the LNG plant at Prigorodnoye at the southern end of Sakhalin island – which remains largely ice free year round. The Phase 2 project will also enable year round production from the Molikpaq following the installation of offshore pipelines that will bring the oil ashore at Piltun Bay.

Additionally, the project will require major upgrades to the island's infrastructure – such as roads, bridges, airports, railways and ports – which will be funded by Sakhalin Energy in support of both the project and the island. Work on the infrastructure upgrades has already commenced, and is expected to cost about \$300 million.

Construction activities of the project elements are dependent on Government environmental and construction approvals, which are expected to be completed within the next three months. Subject to the approvals, year round oil production is expected in 2006, with first gas production from Lunskeye in 2006. Deliveries from the new LNG plant are planned to commence in 2007

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