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Shell May Cut Reserves at Least 4 Percent on Sakhalin (Update1)

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By Stephen Voss and Torrey Clark

Dec. 29 (Bloomberg) -- **Royal Dutch Shell Plc**, Europe's largest oil company by market value, will cut its proven oil and gas reserves by more than 4 percent when it gives up half its stake in Russia's Sakhalin-2 venture, analysts said.

The equity transfer to state-run Russian energy company **GAZPROM** is expected to be completed by the end of February, and may not be reflected in Shell's reserves number for the end of 2006. Shell reports proven reserves once a year, usually around March, giving yearend totals for various geographical areas.

"This comes at a bad time for Shell, after writing down reserves just a few years ago," said **Jeffrey Woodruff**, an energy analyst with Fitch Ratings in Moscow.

"Not only is Gazprom going to join the project, but it's taking a controlling stake."

Shell could lose 500 million barrels of reserves, according to **Daniel Barcelo**, an analyst at Bank of America Securities LLC. That's about 4.4 percent of Shell's proven reserves at the end of 2005. **Emmanuel Dubois-Pelerin**, a managing director at Standard & Poor's Rating Services in Paris, estimates a 9 percent cut.

Any reduction will be a blow to Shell, already struggling to find more resources after slashing reserves and ousting the group chairman in 2004. Last year, led by Chief Executive Officer **Jeroen van der Veer**, Shell replaced 67 percent of the oil and gas it pumped, compared with 95 percent at competitor BP Plc.

Shell's London "A" shares closed at 1,785 pence today, ending the year 0.8 percent up, compared with an 8.3 percent drop at BP and a 37 percent gain, so far, for Exxon Mobil Corp.

Russian Control

Shell and Japanese partners Mitsui & Co. and Mitsubishi Corp. agreed last week to sell half of their stakes in Sakhalin-2 to state-run Gazprom in return for \$7.45 billion in cash. The agreement gives Gazprom a 50 percent stake, and the holdings of Shell, Mitsui and Mitsubishi drop to 27.5 percent, 12.5 percent and 10 percent, respectively.

The venture, which is building Russia's first liquefied natural gas export terminal, had been an anomaly as the only major Russian energy project completely owned by foreign companies.

The deal bolsters Russian President Vladimir Putin's control over the country's energy industry and ends a yearlong campaign in which the government threatened to cancel building permits on environmental grounds and refused to approve project budgets.

Sakhalin-2's recoverable reserves comprise about 4 billion barrels of oil equivalent, said **Ivan Chernyakhovsky**, a Moscow-based spokesman for Sakhalin Energy Investment Co. Ltd., the joint venture that runs the project. Shell doesn't disclose the quantity it has booked as a "proven reserve" on a project-by-project basis, said Shell spokesman Jonathan Charles in London.

Losing Reserves

At the end of 2005, Shell's worldwide proven oil and gas reserves were 11.466 billion barrels, 3.5 percent down from 11.882 billion a year earlier.

Shell's reserves in Sakhalin are included in the geographical region of Middle East, Russia and former Soviet states, where reserves rose by 520 million barrels through 2005 to 2.703 billion barrels at the end of that year.

"Assuming that Shell has booked 40 to 50 percent of Sakhalin, we would expect to see a transfer/sale of 500 million barrels of oil equivalent to account for the reduction in its stake," Bank of America's Barcelo said in a Dec. 21 report.

Dmitry Malykhin, the head of Wermuth Asset Management GmbH's Moscow office, estimated last week that Shell could lose 300 million to 500 million barrels of reserves, using U.S. Securities and Exchange Commission reporting standards.

Minority Share

The loss of Shell's majority ownership status may exacerbate the drop in proven reserves. As the major shareholder, Shell was able to "fully consolidate" the Sakhalin reserves in previous years, meaning it could book more than its 55 percent share of the oil and gas expected to be extracted.

In the Middle East and Russia grouping, the minority share of Shell's proven reserves for 2005 was 121 million barrels of oil and 3,059 billion cubic feet of gas, which together make up 648 million barrels of oil equivalent. S&P's Dubois-Pelerin says most, if not all, of that is the minority interests in Sakhalin-2, which Shell will no longer be able to keep on its books once it becomes a minority shareholder itself.

"They will have to deconsolidate" the minority interest, Dubois-Pelerin said.

"We estimate the transaction reduces Shell's year-end 2005 proved reserves by some 9 percent or 1 billion barrels of oil equivalent and proved reserve life of 9.2 years by about 0.8 years."

Zapolyarnoye Reserves

Shell and Gazprom had reached a preliminary agreement in July last year for Gazprom to acquire a 25 percent stake in the project in return for Shell acquiring half of Russia's Zapolyarnoye field in the Arctic. a move that would have helped

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