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UKRAINE'S SEA OF AZOV



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Canadian firm Shelton Canada Corp. focuses on opportunities in Ukraine, an Eastern European country that gained its independence in 1991. The company started working in Ukraine's upstream about two and half years ago, but it previously had a long involvement in its downstream oil activities.

Today, Ukraine is one of the bright spots in Eastern Europe, with a growing economy and surging energy demands. Additionally, great volumes of Russian oil and gas cross Ukraine on the way to Western markets.

Shelton has several offshore projects in the Sea of Azov, a very shallow, northern arm of the Black Sea that is split between Ukraine and Russia. Generally less than 20 meters deep, the Azov is also brackish. It's actually the mouth of the Don River, a major Russian watercourse. Consequently, the Azov freezes in winter, which limits the operating season from April to October.

"Less than 20 wells have been drilled in the Ukrainian sector of the Sea of Azov, and the success ratio has been around 30%," says Richard Edgar, professional geologist and chairman.

During the Soviet era, production was developed in the Azov Sea in structural traps in Miocene- and Pliocene-age sediments. The area never rose to major status, however, because Western Siberia's tremendous oil and gas fields provided more than enough energy for the Soviets. The Soviets even drilled several discoveries in the Azov Sea that were never put onstream.

For Shelton, the match was excellent: "We like brownfield projects that have discovered resources, but that need Western technology and capital to be brought into production," says Zenon Potoczny, chief executive and president. "We're interested in pre-development projects, where the risks are volumes, costs and economic returns."

Shelton's main project is a 96-square-kilometer concession in the Azov's southern part. North Kerchenskaya is in 12 meters of water about 20 kilometers off the coast of Ukraine. Two Soviet exploratory wells identified a resource of 160 billion cubic (Bcf) of gas, which Shelton plans to develop. Operator of the project and Shelton's 50% partner is Chernomorntefegas, an arm of the

state oil company.

Producing analogs for North Kerchenskaya are just 12 to 14 kilometers away in an adjacent concession. Kazantip Field has made 41 Bcf to date and produces 21 million a day. Bulganak Field has made a little less than 20 Bcf and currently produces 22 million. Reservoirs in both are Miocene Maikop.

"We will shoot seismic on our permit this year," says Potoczny. "Late in the year, we hope to start platform construction." The shallow waters and potential ice drift and scour mean the partners will need to install rigid, all-season platforms from which to base operations, including drilling wells.

Once the wells are ready, they will be able to access a nearby pipeline. "And from there we can tie into the rest of Ukraine's infrastructure, which is extensive."

The pricing picture is equally positive. During the next few years, Shelton believes Ukrainian gas will reach parity with European prices. Recently, state-set gas prices were raised to \$5.25 per thousand cubic feet, and Ukraine's new prime minister, Yulia Tymoshenko, is a pro-Western leader who talked about deregulation during her successful political campaign. "That gives us considerable upside on prices as well."

Additionally, Shelton has 150 square kilometers of exploratory concessions in the Biryuchya area in the northern Azov Sea. Prospects are between 250 and 500 Bcf in potential. Shelton and Chernomorntefegas, 50/50 partners on the Biryuchya concessions, drilled a dry hole on the project in 2006 but gained greater confidence in the region's geology. Further work is planned.

Shelton is in negotiations on another project in the Sea of Azov and is looking at potential Black Sea shallow-water licenses. "We're trying to get as many brownfield projects as we can while commodity prices are still low," says Edgar.

Onshore, the company has acquired a mature project in the Dnieper-Donets Basin in the northeastern part of the country. Since the 1960s, Lelyaki Field has produced 380 million barrels of light oil. Current production is 1,000 barrels a day, of which Shelton's net is 300. The company plans considerable development and recompletion work at Lelyaki this year, in which it has net resource potential of 30 million barrels.