

Over 80% of the world's oil reserves are in emerging markets...

Oil prices have surged from US\$10 per barrel in 1998 to well above US\$60 per barrel in 2006. For the countries that sit on the world's oil reserves this has proved a surprise bonanza as the excess revenues flow in to their countries. And while Exxon Mobile may have earned a staggering US\$25 billion in profits in 2005 this pales in comparison to the opaque profits enjoyed by many of the oil-companies in emerging markets.

State-owned oil companies dominate the industry

According to figures published in *The Economist* in 2006 the world's emerging markets sit on some 80% of the world's oil reserves. The problem is that because these reserves are both strategically and politically important they are tapped and exploited by huge state-run oil companies. Saudi Arabia's Aramco is the world's largest of these companies and has reserves 20 times that of Exxon Mobil. Venezuela, Mexico, China, Nigeria, Iran, Iraq and Russia all own the largest oil company in their countries. John Cleary, Chief Investment Officer for Focus Capital says **"but with state-owned oil comes protectionism, political interference and inefficiency"**.

Oil stabilisation funds provide financial reserves

One virtuous benefit however is that many of these countries have put in place something called an oil stabilisation fund. This is essentially a financial reserve into which excess revenues are channelled which is built up when oil prices are buoyant and will be available for use if and when the oil price declines. This allows governments to plan for future spending programs. It also tends to be utilised when spending may help bolster political campaigns. Cleary said, **"politics and petrodollars tend to go together in emerging markets"**

Development of new technologies can increase exploitation

3D seismic imaging is one of the latest technologies that is allowing the oil industry to reduce drilling costs and increase exploitation of reserves. As innovative technologies develop, new reserves may be discovered and become feasible. Emerging market oil companies have the cash to purchase such technology and the political connections to ensure favouritism from their governments. With such technology Cleary says, **"emerging markets look like increasing their share of world oil reserves which is important for everyone"**.

Undiscovered and untapped riches

In the remote regions of Siberia or in the deep seas off China potential oil reserves lay unexplored. On the Saudi-Iraqi border there is an area the size of California waiting to be explored. Currently oil companies want to exploit those reserves that are the easiest to tap. But as new technologies allow these untapped regions to become both accessible and exploitable with new technology, greater revenues can flow to the countries. Oil was recently found in India's Rajasthan. Cleary said, **"new areas of oil exploitation in emerging markets make these countries very attractive for developed market oil companies"**.

Emerging markets should not be ignored

And it is precisely because the developed world has few viable alternatives to oil that makes emerging markets such an important factor in the oil industry. Most western oil-companies have had to increase their exposure to emerging markets as their current reserves are depleted. This could be analogous to investors having to search for higher returns and diversification in emerging markets. Emerging markets have resources and companies that the developed world will increasingly need. Cleary says, **"those people that ignore the potential of emerging markets do so at their loss"**.

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