



MIDDLE EAST/ IRAN
OIL SECTOR:
MAPPING INVESTMENT RISK

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Social Risk Assessment

Ahvaz: New oil wealth

The Ahvaz area of Iran is rich in oil. In 1999 the Azadegan oil field, one of the largest oil fields to be discovered in the past 30 years, was fully explored and is estimated to hold 33.2bn barrels.

Despite the size of Iran's oil reserves, many major Western oil producers have no presence there due to the political dispute between Iran and the US and EU. Several years ago British Petroleum said it could not do business there due to political complications.

Companies from outside the US and EU are likely to have fewer problems entering the country. China has a particularly strong presence. Iran recently signed a deal with China's Sinopec worth \$2bn to develop the Yadavaran oil field. In January 2009, China National Petroleum Corp signed a deal to develop the northern part of the Azadegan field. In the first 48-month phase of the development, output capacity is estimated to reach 75,000 barrels per day and in-place oil 6bn barrels.

Not all companies that enter Iran succeed in overcoming the political obstacles. In 2004, a Japanese consortium led by INPEX signed a deal worth \$2bn to develop the southern part of the Azadegan field. However, INPEX was unable to proceed. The company blamed its lack of progress on landmines that covered the field. Despite a subsequent demining operation by the Iranian authorities, INPEX declined to continue, most likely due to US pressure on the Japanese government.

Oil exploration in Iran falls under the jurisdiction of the National Iranian Oil Company (NIOC), which is owned by the Petroleum Ministry. Like many government bodies in Iran, the NIOC is likely to suffer from excessive red tape and corruption.

Doing business in Iran

Security risks in Iran are low when compared to other oil producers, such as Iraq and Nigeria.

Logistically Iran has a satisfactory infrastructure, including an electricity supply that is mostly reliable and a good network of paved roads.

Iran has a high-level of education when compared to its neighbours, and skilled labour is available. English-speaking employees will be harder to find.

Culturally and aside from any business negotiations, Iranians are likely to be cooperative hosts who are eager to assist foreign companies and their employees.

Iran is an Islamic country with social restrictions. Alcohol is illegal, although it is available on the black market. Iranians are likely to be more flexible and less conservative than the citizens of many Muslim countries in the region, such as Saudi Arabia.

Iran is subject to US and EU sanctions and some imported equipment and parts needed in the oil industry will be hard to obtain. Many foreign companies operating in the country have had parts smuggled from the UAE and other neighbouring countries. Most equipment can be sourced in this .

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Security outlook

Iran's relations with the US continue to be poor. The US has no diplomatic relations with Iran, although back channels are in place. In recent years, hostility between the Bush administration and Iran brought the two countries close to war. The EU does have relations with Iran, albeit under strain from Iran's nuclear programme.

The election of the Democrat administration in the US should be considered positive and the chances of conflict between the US and Iran have reduced as a result. President Obama has said he will engage with Iran and work to improve security cooperation with the country.

However, the policy of the new administration is still unclear; if it takes a hawkish line on Iran and the nuclear programme, this could potentially result in a US or Israeli military attack.

Support for Israel is a mainstay of US politics and Iran's anti-Israeli policies will conflict with Washington. The appointment of the pro-Israeli Dennis Ross as President Obama's diplomatic envoy in the region is an indicator of the new administration's stance.

Aside from tension with the US and Israel, Iran has no other major flashpoint for external conflict, although its location between Iraq, Afghanistan, Pakistan and CIS countries means that it could be dragged into any conflict taking place within or among its neighbours.

Internally, Iran has security problems in Baluchistan and Khuzestan/Ahvaz, where ethnic minorities complain of marginalisation. In Ahvaz there are around two million ethnic Arabs; elements claiming to be a separatist movement have killed around 28 people in a series of bomb attacks since 2005.

In Baluchistan there is no real separatist movement and security problems stem more from general lawlessness and lack of state control.

Iran has a youthful population and three quarters of Iran's 65 million people are under the age of 30. Unemployment (at around 3 million) and underemployment are major problems. Social problems such as drug abuse are on the rise and many young people are dissatisfied with the country's Islamic system of government and its social restrictions.

As a result of this demographic, political change should be expected within Iran, but there appears to be little appetite for radical politics or violent action against the government. It is likely that Iran's semblance of democracy will allow the Iranian population to seek peaceful change through elections.

Relations with China

Iran's relations with China are strong. As a result of US and EU hostility, Tehran has sought to align itself with Beijing.

In 2005 the volume of trade between Iran and China reached \$9.2bn. A series of deals have taken place to supply China with oil and gas. It is believed that a significant quantity of Chinese weapons have been sold to Iran.

Iran and China also share regional policy goals, and both countries have concerns over radical Sunni Muslim elements.

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Politics of the oil sector

As with many oil-producing countries, oil is perceived in Iran as one of the country's most important assets. Iran is one of the world's largest oil producers and historically this has given it a highly strategic role on the world stage.

Control of oil and gas is highly sought after within Iranian politics and as a result the sector has become politicised. This will have a detrimental effect on the management of the hydrocarbon sectors.

Iran has a high level of perceived corruption. The country is not considered to give foreign investors sufficient protection, although for a major company in the oil sector this may not apply.

Iranian law does not permit direct equity stakes or concessionary rights in the oil sector. Instead the country allows buy-back contracts, through which foreign companies pay for all investments in return for remunerations from the NIOC in the form of a share of production. Upon completion of the contract, the company's operations are then transferred back to the NIOC.

This system can cause problems for both the NIOC and foreign companies in that the NIOC offers a fixed rate of return regardless of the oil price. Foreign companies are not given any guarantee that they can develop discoveries.

Future Iranian politics

Iran has presidential elections on 12 June 2009. There are a number of candidates but two names that stand out are Ali Larijani and Mohamed Ghalibaf. Ghalibaf is currently the mayor of Tehran and there is an obvious precedent in this case as the current president, Mahmoud Ahmadinejad, was also mayor of Tehran before his election. Both names are likely to be acceptable to the Supreme Guidance Council.

It is possible that Ahmadinejad could be re-elected, and he may have the backing of the Revolutionary Guard. However, it is likely that the Iranian electorate will seek political change.

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Marker Global's information is exclusive.

All information in this report has been researched and collated locally by Marker Global's analysts.

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Further information

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