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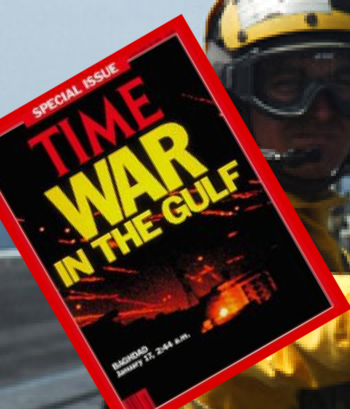
The Great Game

The ongoing conflict for control of the world's oil and natural gas supplies

Developing The world's last giant oil and gas fields

Special Report 2007



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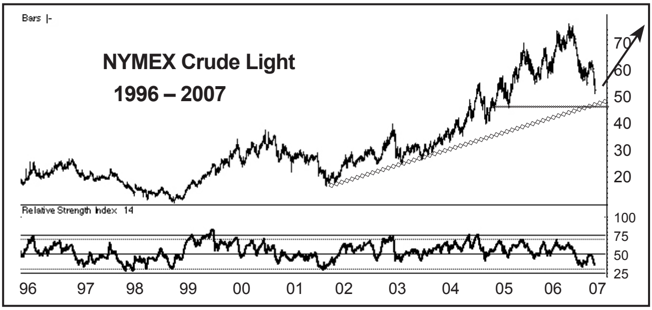
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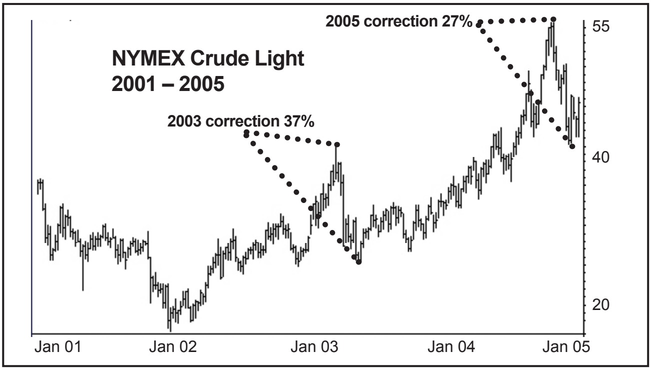
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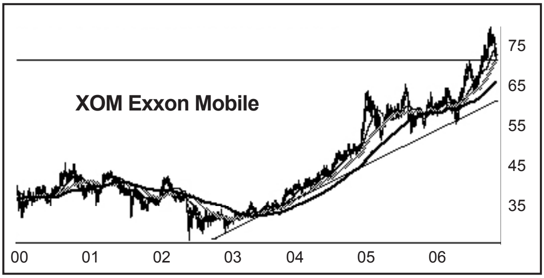
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The Great Game
Introduction

Dear Members,

Beginning in 1907, nearly 100 years of subterfuge, diplomacy and puppet regimes, but never war, ensued as Tsarist Russia squared off with Britain over the control of Persia and indirectly, the jewel of the British Empire, India. The actual impact of Russian or British domestic life, was minimal. In the end, to those populations, that great game amounted to little more than a series of minor, back and forth adjustments, to the respective empires' areas of influence.

The consequences of the 21st century's great game, the quiet rush to control the world's increas ingly politicized, diminishing pools of relatively low cost oil and natural gas, is infinitely more far-reaching. Its impact on the life styles and economies of the Western world will be deeply felt for decades to come. Its risks; the potential arming of radical Islam with weapons of mass destruction; or the empowerment and spread of semi fascist anti western oil rich states, are visibly escalating. At the same time the West's increasing dependence on energy supplied by Arabia, Persia and Central Asia (including Russia) just as China and India obtain long term off-market supplies, adds to the risk that targeted, 1970s-like, oil supply embargoes will again become a reality. At minimum oil and natural gas's prices will soon be controlled by less-than-friendly states. Our energy costs will be set at whatever they think our economies' can bear. And that will translate to much higher oil and natural gas prices in the coming years.

But there is reason for some optimism. The West's advantages, are powerful; free speech, high levels of literacy and research, and the consequential near-parabolic acceleration in technological discoveries, should , in the long run, allow us to prosper despite higher energy prices. But the competition for resources will remain a great challenge in the 21st century. We must remember that the explosively growing emerging market countries have barely begun to consume. They have 85% of the world's people but only account for 20% of its GDP. We must also be aware that our technological lead is slipping alarmingly. Even the traditional US surplus in hi-tech goods has moved into a deficit. This is not surprising, America's research spending has decelerated to 4% annual growth compared to a blistering 20% in China. Now the Chinese are beginning to champion their own high quality brands. Far more worrisome is that they are now also designing and building their own sophisticated weapons systems. Last month the country test flew, for the first time, a 100% designed and built in China, fighter jet.

And just last week they actually shot down a satellite, joining Russia and America as the only nations to ever accomplish that military feat.

As we have discussed in previous Equity Research bulletins, the Asian economies have grown financially stronger and are becoming far less dependent on exports to the West. Just last week they began negotiations to form their own Asian free trade zone – a 10 country, $9 trillion (economic output) trading block that will easily rival both the protectionist European Union and America. More dangerous is this block is pulling far ahead of the West in ensuring the direct delivery of energy over the coming decades.

Fortunately the rise of Asian power is not a zero-sum game, as globalization translates to cross ownership of Eastern and Western companies and growing mutual interests. We expect the East to also help solve the challenges that arise from expensive energy as it develops and supplies energy-saving technologies and products to the West. It is a small comfort as Western nations will still be left out in the cold, as the East increasingly ties up much of the world's new oil and gas production and the West ends up paying a far higher price for what is left.

In this report we show the evidence of these alarming but opportunity-producing trends. We build what we think is an air-tight case, for increasingly costly oil and natural gas in the com ing years. We high-light the various investments that are expected to be substantial beneficia ries. Equity Research has chronicled and predicted since 2003 the development of this major trend. As it has unfolded virtually all of our investments have benefitted substantially – some appreciating hundreds to as much as 1,000%. We think it timely to be issuing this Report as we expect this latest energy market correction to be nearly over if not already complete. Consequently there are some excellent buying opportunities.

As with any correction the "big picture" remains of paramount importance. The energy mar ket's big picture tells us the long term bull market is very much intact. Reserves are not being replaced and overall supply-demand remains historically tight regardless of the mild winter weather, or the correction exaggerating impact of short term speculators unwinding their long or written put positions. Long-term charts of oil, its producer's indexes and bell-weather Exxon all remain in bull market up-trends. Even the latest crude price drop looks a repeat of past bull market corrections. The 2001 to 2005 chart of NYMEX Crude is a great example (see inside cover). Prior to oil's 2006 run to a record $76 per barrel its previous end-of-move highs to $55 and $40 were both followed by a respective 27% and 37% corrections. Both had a pattern consisting of two down waves divided by an intermediate up wave. Bullishly the *last few months' correction has the same pattern and has dropped a similar (37%) percentage. Also so typically the world's press has been trumpeting bearish-sounding news just as oil prices are nearing what we think will be secular lows.*

The Wall Street Journal's *(Europe) headline on January 19th, "Rich nations burn less oil" is a great example. It simply is not news. The Western (OECD) countries were never expected to experience meaningful growth in the current environment and there decline (0.6%) is miniscule. The growth in oil consumption has always been about Asia. Last June this statement in a report by America's EIA was ignored by the world press because it contradicted the overwhelming consensus that oil prices would rise indefinitely. The EIA stated: "Economic development in Asia will be crucial to long-term growth in oil markets. China, India, and the other nations of non-OECD Asia are expected to experience combined economic growth of 5.5 percent per year between 2003 and 2030, the highest rate of growth in the world... In the United States, a 0.4-percent decline in oil demand in 2005 resulted from a combination of high prices, hurricane-related disruptions, and a mild winter". That was last June when the EIA's report regarding soft demand from the oil market's largest (and among the slowest growing) consumers was ignored. Now that speculative (hedge fund) long posi tions in the oil futures markets have collapsed to about 25% of what they were last summer and oil is down roughly 37% the Wall Street Journal article is predicting lower prices.*

Our research leads us to conclude that from now on, any energy market surprises, are far more likely to involve rising energy prices; and, as we maintained in 2003 and 2005, this is a buying opportunity.

Knowing all this I think it is critical that we are all aware of the major geopolitical trends which we describe in this and previous publications. That we are financially prepared for a further round of rocketing energy princes and invest accordingly. Fore-warned and armed with the right investments, we expect our members will prosper even more in coming years, than they have in the past.

Wishing you all the best in 2007 from The Equity Research team and myself,
my warmest regards,

Conrad Weiss
CFA, Editor

The 21st century energy bull market

The rise of the state sponsored oil sector

What does it mean and how may we may profit?

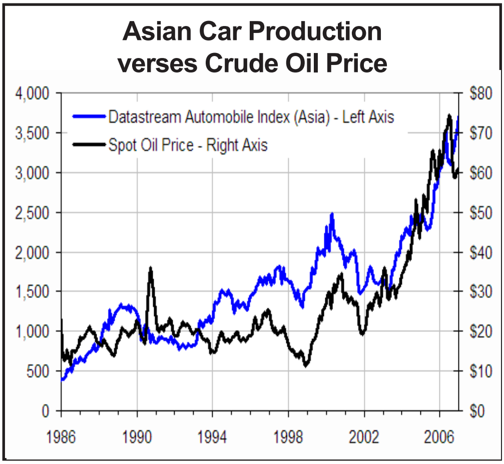
It is the 21st century's great game. An intense conflict for the future control of the world's energy supplies. And it is escalating. **OPEC** and now a new breed, we'll call the "*state sponsored energy company*", are winning, and together they already control over 70% of the world's oil and gas. Western oil compa nies and countries have been ill-prepared. Their politicians impose no-go zones in oil-rich places such as **Sudan** and **Myanmar**. Their companies' remain hobbled by limited access to cheap capital, and the need to produce short term profits. The vapors of government aid on offer (which just might help secure the next big concession) are too often bound in a straight-jacket of liberal establishment conditions.

The West's competition, the state sponsored energy companies, enjoy a card shark's advantage. Their access to oil assets, if necessary, can be greased by an easy no-questions-asked flow of foreign aid. They are not restricted by poli tics, no matter how genocidal, and they have a near-endless supply of cheap cash. In this game their state shareholders' are already making bold moves that prepare for the decades ahead. Their objective is simple: to capture, at the best price for future years, the oil and gas they know their billions of citizens will one day need.

China and the Asian Tiger's unquenchable thirst for oil still drives the energy bull market.

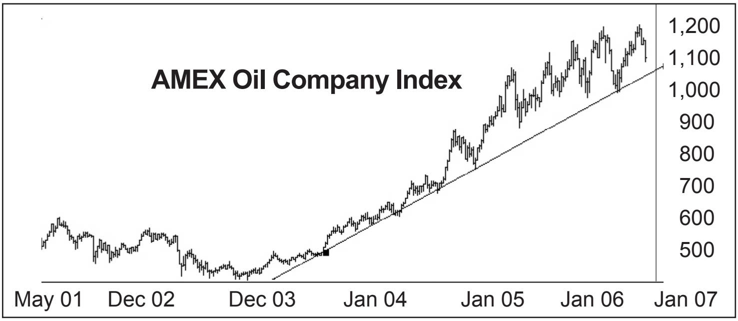
In December 2006, China's crude oil imports surged 31%. According to **Chinese Ministry of Commerce** figures, the country's 2007 net im ports of crude are expected to total 144 million tons or almost one billion barrels – a record amount. By 2020 they are expected to nearly triple, to 400 million tons. Vehicle sales, as the chart below demonstrates, correlate closely with crude oil. And they have taken off as demand for cars and trucks continues to accelerate. Critically, that market has barely been scratched, and Asian consumers are so flush that most pay for their cars with cash. The Chinese bought 7 million cars and trucks last year. They are now the second largest car market in the world and account for fully 10% of global demand. This is just the beginning.

The National Development and Reform Commission, China's top economic regulator, says that the country's annual GDP could reach 20 tril lion yuan (US$2.55 trillion) this year, with a year-over-year growth of 10.5%.



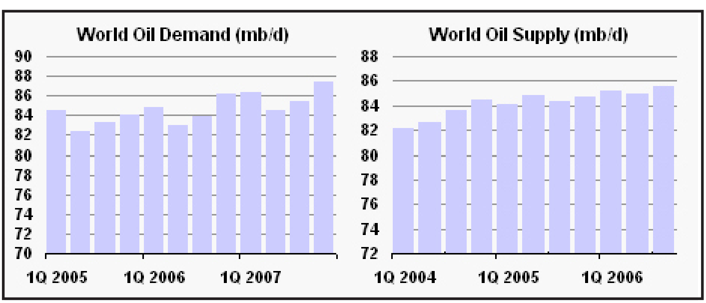
But as Asian crude needs boost global demand, sup ply growth is failing to keep pace. Last December the **Energy Information Administration** (EIA) revised downward its estimate of 2007 non-OPEC oil pro duction by 115,000 barrels per day. **Lehman Brothers** expects this year's non-OPEC crude supplies to grow by 1 million barrels per day, – 700,000 barrels per day short of what we will need. You wouldn't guess it from watching the latest oil price drop, as this non-winter's balmy weather has masked the looming supply crisis. On a year over year basis, OPEC production is already down about 1.2 million barrels and a further 500 thousand barrel per day OPEC cut is about to be implemented. "The global oil market is already tighter that it was a year ago" say the researchers at **Raymond James**. According to the **Energy Information Administration** excess oil production capacity is still near a 30 year low - roughly 3% of global demand. This historically tight spare capac ity means that risks are not skewed towards lower oil prices but that instead, any sudden supply disruption is likely to cause oil prices to rocket.

Adding further to the case for higher energy prices is the current decline in crude inventories as they are effected by a stronger US consumption and OPEC cuts. A report by **Marketwatch.com** says that the US is currently under supplied by 800,000 barrels per day. Towards the end of last year US crude supplies plummeted 20 million barrels – the largest 5 week drop since hurricane Katrina in 2005. On December 28th the EIA said US crude sup plies dropped 8 million barrels – four times analysts' expectations.



Concentration of oil and gas reserves between OPEC and Russia significantly reduces long-term downside risk.

OPEC currently supplies 42% of world production while Russia accounts for a further 11%. Together they control 53% of the market. Most OPEC and all non-OPEC producers are already pumping oil at 100% capacity. The swing production as usual is really in the hands of Saudi Arabia. At last count OPEC production estimates for December showed another 245,000 bar rels per day offline, bringing the total supply cut since November 1, 2006, to roughly 800,000 barrels per day. Not surprising, Saudi Arabia is the only member that has reached its target cut and state-owned Saudi Aramco says it will reduce February supplies to Asian refineries by 12-14% as part of OPEC's second cut. They know the oil market better than anyone and would not cut production unless supplies were reasonably tight and they thought it would be effective in keeping the year's average oil price high. Because of the historically low excess capacity, it makes sense for OPEC to fine tune the oil market's short-term imbalances by adding or subtracting the volume of oil produced. The math is simple. If by cutting back a total of 2 million barrels or 5% of its production, OPEC ensures that the year's *average* price for oil is $60 instead of a non fine-tuned $45, they will be ahead. Why? Because by withholding that 5% from the market, income from the remaining 95% at $60 is more than 100% of the original volume oil sold a $45 price. And



Source: IEA

Still near balance: supply vs demand...

they have still have the 5% to sell at some future date. Naturally it makes no sense to do this unless you expect oil to become in short supply again. Russia acts as if it has a similar attitude. It is a well known fact that **AOA Gazprom**, Russia's largest (state controlled) energy company vastly under funds upstream and downstream development and maintenance. Gazprom and the Kremlin have made it a priority to instead acquire as many upstream and downstream assets as possible, while they jack up prices paid by their captive energy customers. In only a handful of years Gazprom has attained the largest (adjusted) reserve life of any super-major. It is almost three times **Royal Dutch Shell's** and nearly double **Exxon Mobils**'. The Kremlin is unlikely to sponsor such a strategy, unless they were confident that energy was about to get a lot more valuable. Russia already controls a quarter of the world's natural gas reserves and produces 11% of its oil. Most of its gas comes from a handful of Western Siberian gas fields, it admits are in serious decline.

But Russia is in the cat-bird seat, and its numerous Ex-KGB apparatchiks are a high ly intelligent and gifted breed who know what lies ahead better than anyone. And they are scrambling to capture the lion's share of energy assets where-ever practical.

The decline of Western oil exchanges' dominance .

Russia also appears to be leading an effort to undermine the West's oil trad ing system and further politicize energy. A November 2006 report in the **Asia Times** by **Joseph Stroupe** highlights this risk. It outlines how prior to the 1973-74 Arab oil embargo most oil was traded on the basis of long-term oil contracts. The embargo was an attempt to punish the US and Eu rope for supporting Israel during the Yom Kippur war which started when Syria and Egypt attempted to destroy the Jewish state. Or as the head of the **Arab League** at that time infamously declared "*drive them into the sea*". Following the embargo, Britain and the US started a US dollar denominated

London and New York based futures market for world oil production. The market to this day has acted as a virtual pool from which supply disrup tions in one part of the world are efficiently offset by sources of production in other parts The result was specific consuming nations could no longer be individually targeted by oil embargoes as occurred in 1973-74.

Is the world oil trading system being circumvented in an effort to re-politicize energy supplies?

Russia, the report says, is leading an effort to enable targeted embargoes by establishing state-to-state long-term supply contracts. The report describes a situation where Russia has already established a vast, worldwide web of alli ances with rigid long-term private supply contracts between the world's state oil producers and economically ascendant Eastern Asian countries. In tes timony to a **US Senate Committee on foreign Relations**, (which was reprinted in the article), **Mikkal Herberg** of the **National Bureau on Asian Research** said "*China has signed some form of strategic partnership with nine countries including Russia, Sudan, Iran Venezuela, Brazil, Angola and Kazakh stan*." This did not include Stroupe writes " *the profoundly important strategic partnership agreement China signed with Saudi Arabia last January*". Herberg noted in the same Senate testimony "*currently two-thirds of the Gulf's oil exports go to Asia and this will grow sharply in the future*. He later adds his assessment of the negative effects of these private agreements on the liquidity of the US-led oil trading market:

"Their implied strategy of locking up control... in effect taking oil off the market... is likely to contribute to higher oil prices and price volatility by reducing global market flexibility to handle tight markets, shortages and supply disruptions".

Russia just increased its ability to blackmail the EU.

Russia is also adding to its political power in the EU, by increasing its stran glehold on Union's natural gas supply. Gazprom, the previously discussed state-controlled (publicly traded) Russian natural gas monopoly, agreed last week to supply natural gas to **Gaz de France**, Europe's largest natural gas supplier, until 2030. Gazprom made the deal on the condition it would be al lowed to sell its gas *directly* to French consumers. Italy's **Eni** signed a similar deal with Gazprom in November, purportedly in the hope that it will gain access to Russia's lucrative east-Siberian oil fields. Gazprom already supplies roughly a third of the EU's natural gas and the recent deals move it towards almost doubling this amount.

Virtually all of Russia's 6 million bpd oil exports go to Europe. Gazprom's heavy handed treatment of the Ukraine, just as it's *Orange Revolution* had it tilting towards the West a year ago, put European powers on notice that if they wished to stay warm in the winter, they better had be cooperative with Russia (as they were regarding Iraq) on geopolitical issues. But will that even be enough? Russia's recent strong-arming of Belarus, a former close ally, tem porarily halted the flow of two million barrels of oil per day to Europe, 20% of its total imports. The dispute began in November when Gazprom raised the cost of Belarus's natural gas imports. It was settled after Belarus agreed to Gazprom's increases and to give Gazprom a 50% stake in the Belarus state-owned pipeline, **Beltranzgas,** in order to pay for the added cost of the more expensive gas. Late December the dispute re-ignited when Russia added an export tax to the country's (below the world market price) Rus sian oil imports. Belarus countered with a transit tax and started siphoning European-bound Russian oil from the **Druzhba** (friendship) pipeline which spans the country. Russia then stopped the flow of oil through the pipeline. That a Russian argument with one of its own allies suddenly deprives Europe of 20% of its oil imports, adds weight to critics' worries that these deals will eventually compromise the Union's political independence and that, Russia (*we think obviously*), will put its own interests' first. Those interests, as the record shows, may be light years from what is good for Europe.

The increased politicizing of energy is bad news for the West's super-majors.

On the other hand the same global Gazprom-like oil nationalism will con tinue to reduce the ability of super-majors such as **Royal Dutch Shell** and **Chevron** to grow their reserves and production over the coming years. A study by **Harrison Lovegrove** of 209 E&P companies concludes when referring to efforts to grow through exploration and development "*attractive investment opportunities are diminishing rapidly*." The consequence is cash-rich oil and gas companies' find buying their own shares and paying dividends more attractive than their core business of exploration and development of oil and gas prospects.

According to the study the 209 companies spent $65 billion on share buy backs, $63 billion paying dividends and only $60 billion on acquiring and maintaining leases and exploration.

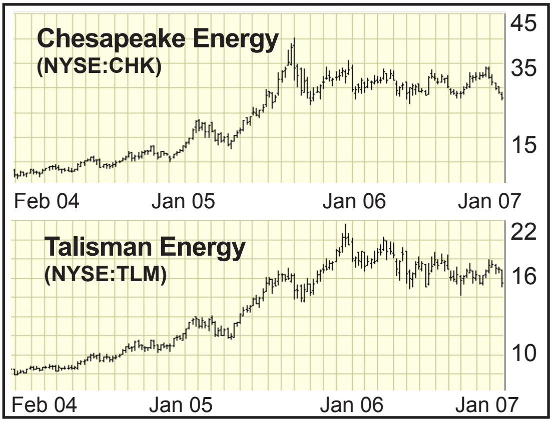
In 2005 the West's oil majors only found enough new oil to replace 75% of the year's production. **Shell** replaced only 67% of its reserves while **British Petroleum** replaced 95%. **Norway's Norsk Hydro** recently announced it would miss its 2010 output target by 7% and then merged with the coun try's **Statoil** in a deal driven by both companies' need to expand drilling prospects. The Super-Ma jor's world has already shrunk dramatically from having access to 85% of the world's oil reserves in the 1960s to their current 10%. All this makes it increasingly clear that the sun has set on their dominance of the oil and gas world.

Will big oil be forced to increase its pace of acquisitions ?

Will they follow state sponsored oil companies' example by purchasing their smaller more nimble Western competitors? The dismal performance of Major exploration and production (E&P) companies in America's domestic natural gas market over the past five years, may be a good indication of how they will do internationally. That is if, as occurred in the US natural gas sec tor, the majority of new international prospects consist of smaller unconven tional fields. *The Major E&P companies' domestic US natural gas production has plunged more than a third since 2000.* Knowing this, it seems obvious that as the available prospect size continues to decline, Big Oil will be forced to acquire mid-sized E&P companies or face extinction.

If it is any consolation to the Super-majors, at least the price looks right. Only seven years ago the S&P Energy Index's average P/E ratio was 30 and expensive. Now 10, it's companies look like bargains. Most E&P companies also have extremely strong balance sheets and sizeable (average multiple a low 5.2) cash-flows.

Only a few weeks ago **Forest Oil Corp.** announced its agree ment to buy the smaller **Houston Oil** for $1.5 billion. On the same day **General Electric** one of the world's larg est and most successful companies said it was paying $1.9 billion to acquire **Vetco Gray**, a



Houston-based equipment supplier to the oil and gas market. These trans actions likely mark the approach of the correction's bottom. Mid caps that have large high-quality drilling inventories, such as **Chesapeake Energy Corporation** (NYSE:CHK $27.50) and **Talisman Energy Inc.** (NYSE: TLM $15.50) are likely takeover candidates, and we have just started to accu mulate them. Critically, as these companies are bought-out, investors will return in search of similar oil and gas equity investments. This dynamic will force a revaluation of the sector and drive its shares higher.

Super-major's find just keeping what they have is getting a lot harder.

Clearly deals by the Western majors to acquire and develop new giant oil pools are getting increasingly rare. Worse yet, many majors, whether in Rus sia or Venezuela, are finding it harder to keep just what they have. Lately we have been more likely to hear about assets they have lost. The most recent example is **Royal Dutch Shell's** "forced sale" of almost half of its Russian **Sakhalin II** interest to Gazprom for $7.45 billion. The Sakhalin II was already a source of trouble for Shell. Last summer the Dutch Super-major raised its estimate of the project's cost to $22 billion, nearly double the origi nal amount. According to **Standard & Poors**' analyst, **Dubois Pelerin**, the reduction in Shell's Sakhalin II interest from 50% to 27.5% could slash the company's year-end 2005 reserves by as much as 9% or 1 billion barrels, while reducing its current proved (unadjusted) reserve life from 9.2 years to 8.4 years.

Sakhalin no source of cheap oil.

While it was to be an important addition to Shell's reserves, Sakhalin II was no bargain. Using the field's projected peak production of 400,000 boe/pd and $22 billion price tag, Sakhalin II's capital cost had mushroomed to a breath-taking $55,000 per flowing barrel of oil. That's even more that the still eyebrow-raising per flowing barrel cost of last fall's Gulf of Mexico (GOM) ultra-deep **Jack** discovery. The Jack's $32,000 cost dwarfed previous shallow GOM well development costs which used to average roughly $2,000 per flowing barrel. The majors pursue these high-cost projects because they have to. Cheap to produce oil is history.

Even Russian projects under development show the days of cheap oil are long gone.

Standard & Poors' Credit Week analyst **Alison Dunn** says the previ ous " *double-digit growth in Russian oil production early in the decade was due to a re bound from the depressed output levels of the 1990s and could not have been sustained. But even to maintain slower growth, Russia will have to make more costly investments in remote fields and transportation networks, as all the "cheap" opportunities for in creasing production have been used."*

Russian oil nationalism impacts Exxon and BP's reserve growth, is France's Total next?

Exxon Mobil's Sakhalin I production sharing agreement is not being ex tended, as previously agreed, to include the recently discovered (by Exxon) offshore Sakhalin **Lebedinsk field**. Instead Gazprom has been given the right to develop it. In the meantime Gazprom is maneuvering to acquire a 50% stake in **TNK-BP** which produces over 1 million barrels per day in Western Siberia, and is Russia's third largest oil company. If Gazprom is successful, **British Petroleum's** oil reserves will take a significant hit. France's **Total** has at risk its smaller **Kharagya** field now that Russian government officials are publicly complaining that the project's special tax status is "disadvantageous" to Russia. Recently the country's **Minister of Industry and Energy, Viktor Khristenko**, criticized the Sakhalin and Kharagya PSAs, saying:

"they were signed during a time when the Russian state was weak and oil prices were low, and that the state would never sign such preferential deals with foreign oil companies under current circumstances".

The Rise of the quasi-state oil company

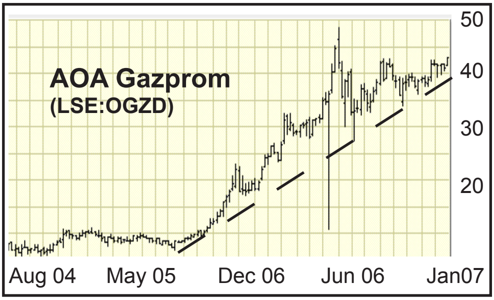
Excluding pure state oil companies such as Venezuela's PDVSA or Iranian State Oil Co., most Asian state supported oil companies embrace the man agement and technical elements that made Western big-oil companies pre viously so successful. But they also have giant government supplied slush-funds and anything-goes political support. As a consequence they have been dominating the rush to tie up the world's remaining undeveloped energy as sets – largely at the Super-Majors expense. Many of these partially privatized, publicly listed companies shares, have also been on a tear as big-oil retreats in the face of these politically and financially formidable new kids on the block. **PetroChina** is a great example with its $252 billion market cap it has grown by 20% in the past year. **Sinopec, China Petroleum & Chemical Corporation's** 2005 3,786 mmboe proven reserves look set to reach 5 bil lion barrels a 25% increase in less that two years! (This includes it's about to be completed acquisition of a 50% stake in Iran's off-limits to the West's oil majors, **Yadavran** field). It is acquiring assets everywhere from Iran to An gola in a race to capture the world's remaining major oil plums. Investing in these ideally positioned giant state oil compa nies has been a good way to profit from this trend and we are doing that. Another great op portunity is investing in smaller, more nimble

and connected private oil companies as they develop little known oil assets and then sell them to either big oil or Asia's fast growing state supported oil majors.

**If you cannot beat them,
Join them ... Buy Gazprom.**

A better strategy than investing in reserve growth challenged oil majors, is to invest in the world's largest, publicly traded state energy monopolist **AOA Gazprom** (London Stock Exchange: OGZD $43). It has huge growth pros pects and near-monopolistic powers. Gazprom has total control of Russian gas exports and near total control of production. With its capture of half of the giant Sakhalin Island project it will also get access to Shell's LNG exper tise which could be why it is in no hurry to develop (and farm out) part of its giant Barents sea **Shtokman field**.

The Shtokman, which was discovered in 1988, has 112 trillion cubic feet of gas and over 200 million barrels of condensate. Producing the field requires state-of-the-art western technologies and expertise possessed by companies' such as Shell and **Statoil** (which already produces gas in the Barents sea) and which Gazprom, a direct and indirect 100% owner of the Shtokman, would like to get. The Sakhalin II deal brings Gazprom a step closer to hav ing the ability to develop the project albeit a decade or so from now.



If Gazprom expects gas prices will be appreciably higher in the future, then it remains in its interest to hold off developing the Shtokman. This may be Gazprom's strategy to defer the development of such an expensive to develop and technically challenging giant 100% owned asset. A recent article in the **Energy Tribune** supports this observation. In the article a high ranking Gazprom manager says: "*Today Shtokman's resources are worth $16 billion but in 10 years that amount could triple. A natural question for the government is why give our riches to somebody else*".

Technically Gazprom's shares look ready to break out from a seven month consolidation after the energy sector's correction is complete. We give the shares a $70 price target. Factoring in the Russian governments 50% interest, Gazprom is now larger than Microsoft, making it the world's third largest company. Morgan Stanley Capital International Emerging Market Index in creased the company's weighting on the index to 4.8% last year. Gazprom's success in capturing prize FSU and Russian assets while at the same time forcing its FSU customers to pay world market prices for natural gas is bound to be re flected in considerably higher prices. We are further encour aged that Gazprom shares have been relatively stable during the energy sector cor rection. Gazprom shares are a conservative overweight buy.

Will Russian oil ministry plans to clamp down on illegal excess production further reduce world oil supplies?

In a statement last month the Russian oil ministry complained that illegal oil production accounted for roughly 1 million barrels per day of production, but produced no tax revenues and was of no benefit to the state. The minis try plans a drive to eliminate this practice. By mid 2007 roughly 60% of the oil industry (up from 30% in 2006) is expected to be back in State hands making spotting black market production much easier. This could be one more market-tightening trend that moves oil prices higher. Any reduction of this black market supply from the global oil pool will further add to the global oil supply tightness.

Respecting the undercurrent of nationalism was always an integral part of successfully operating in Russia.

Shortly after the Soviet Union's break up, one plucky little junior we had invested in called **Bitech Petroleum** began working to develop oil fields in Russia's Komi Republic. In what turned out to be a prescient comment, its Chairman **Ray de Schmidt** (a former head of Schlumberger's Russian op erations) emphasized that if Bitech was to be successful it would need to not only be seen as a Russian company but also "*stay off the radar screen*". Clearly the super-majors have done neither. Bitech, which had prominent Russians as shareholders, was taken over in 2001 by Lukoil at a significant mark-up from its original price. The lesson: *there is money to be made in Russia but you must keep your interests small and have a Russian big-brother as a partner.*

The next source of bad news (if you're big oil).

While Russia is clearly not the oil-reserve-increasing panacea the super major's had hoped for, Venezuela has also become another source of increas ing concern. **Exxon Mobile** has already announced it will be making no further investments in the region. Fresh from his December election win, and armed with a six year term, the country's president, **Hugo Chavez**, says he will impose an "extraction" tax on oil companies operating in Venezu ela, as well as increasing income taxes for the foreign companies along the Orinoco Belt. The multinational-developed and managed Orinoco fields, supply 600,000 barrels per day of heavy oil or roughly a quarter of the country's production. They have been one of the country's few success stories, especially compared to the country's ailing state oil company **PDVSA**. According to ex-PDVSA President **Luis Giustiince**, since Chavez was first elected president in 1988 *"PDVSA's production has plunged from 3.4 million to 1.5 million barrels per day"*. Once higher taxes and increased Venezuelan state interference becomes a reality in Orinoco, a PDVSA-like performance should be expected and another source of diminishing world oil supply will be assured.

Nigeria's oil industry deteriorates.

The violence continues to escalate in Nigeria. It is America's fifth largest oil supplier and the world's eighth largest oil exporter making it an important oil supplier. Two weeks ago a Royal Dutch Shell oil complex was attacked and three Nigerian hostages taken. More than 50 kidnappings occurred in 2006. Last week Nigerian oil industry spokesmen say armed groups lifted sieges of two oil field stations in the country releasing more than 20 workers. The attackers also briefly occupied an adjacent flow station which controls pipeline networks. Attacks on pipelines and oil facilities have cut Nigeria's output of 2.5 million barrels per days by about a quarter this year. They are becoming increasingly common and more violent. Assailants range from militants wishing a greater share of the oil wealth and more autonomy, to criminal gangs looking to collect ransom for hostages. In response to the increased activities of the latter, the Nigerian military razed a shanty town surrounding Port Harcourt which was thought to be harboring some of the gangs. There remains a definite trend of increased violence and oil blockages which further adds to global supply risk.

Iran threatens the Western energy order.

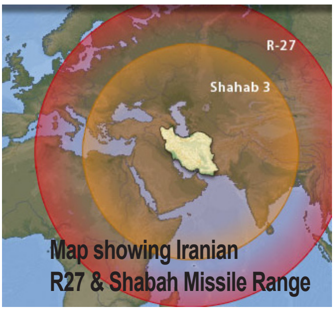
For years Iran has been one of the Persian Gulf's most persistent trouble makers as it continually threatens the US and Israel, pursues nuclear weap ons, and both arms and bank rolls Iraqi insurgents, Syria, Lebanon's Hezbol lah and Palestine's Hamas. The country's bellicose President **Mamoud Ahmadinejad's** days look numbered as Iran's Supreme Leader **Ayatollah Khamenei** dies of cancer and even the country's conservative publications write articles critical of him. But Ahmadinejad's likely replacement, **Hashemi Rafsanjani** will not improve the world's geopolitical risks. The sweet-talking Rafsanjani's word's merely sugarcoat, for the West's consumption , the same Basiji agenda (developing nuclear weapons to use against the West, the destruction of Israel and the creation of an Iranian dominated Islamic Shiite crescent).

The country's 137 billion barrels of oil reserves are second only to Saudi Arabia's according to the **BP Statistical Review of World Energy**. But while the dysfunctional regime has shown itself to be very adept at exporting terrorism, its oil exporting record has been less impressive. Iran's produc tion has fallen from 6.1 million barrels per day when the Islamic regime first took over in 1978 to just 3.9 million barrels of oil a day this year. Of this it exports 2.4 million barrels of oil per day – 5% below its OPEC quota. *Iran is currently expected to reduce its exports by 250,000 barrels per day every year before it ceases to become an exporter.*

Similar to Venezuelan state oil company PDVSA the country's **National Iranian Oil Co.** suffers from a lack of technical expertise and chronic under funding as most income is diverted for political purposes. This in cludes subsidizing refined crude by-products which are sold to the Iranian population at a fraction of the world market price, a practice which allows breathtaking levels of waste. A **Deutsche Bank** study, for example, esti mates that Iran's 7 million cars consume 420,000 barrels per day of gasoline – roughly the same amount as Britons 35 million cars. More ominously, what money is left has been poured into Iran's Nuclear program despite ac cording to the CIA's fact book, 40% of its population living in poverty.

Last September, **Iranian Oil Minister Kazem Vaziri-Hamaneh** said "*that with no new investment, output from Iran's fields would fall by about 13% a year*" almost twice the rate that outside oil experts had expected. In a recent **Reuters** interview **John Hopkins University** researcher **Roger Stern** said "*Iran's exports could dwindle to almost nothing by 2015 if Iran did not change its policies*". *That would mean the removal of 2.4 million barrels of oil per day from the world's oil supply in the next seven years.*

Iran's growing population needs about 80,000 barrels or 5% more oil every year, further reducing the amount available to the world market. What new production that is slowly being developed is destined for Asia under long term contracts with large state oil companies that are not restrained by US-led sanctions. The latest is a likely, yet to be announced, $16 billion deal to develop Iran's **South Pars** natural gas field, which is thought to hold a tenth of the world's gas reserves, in exchange for 50 percent of the field's liquefied natural gas production. State-owned **China National Offshore Oil Corp.** (CNOOC), is expected to proceed, despite a warning from the United States on possible sanctions against it. (Shell and **Repsol** are also thought to be vying to developing the field but the actual outcome is uncertain as they will be even more exposed to US sanctions.) Critically these contracts keep this new oil and gas from replenishing the rapidly diminishing Western reserves. The only possible siginificant Iranian addi tion to the Western futures oil trading sys tem was a now-collapsed deal for the devel opment of Iran's giant **Azadegan** oil field by Japan's **INPEX Holdings Inc**. Rising costs, the potential for an escalation in nu clear weapons-related risk and the failure of Iran to clear mine-fields from the Iran-Iraq war combined to kill the project.



Any Iranian natural gas production growth unlikely to benefit the West.

One area of potential Iranian growth in the years ahead is natural gas pro duction. But its development looks largely to be accomplished via off-mar ket long-term agreements with Asia's (China's) government controlled oil companies. They are at the forefront in tieing up Iranian gas assets because unlike the West's major oil companies, they are more interested in securing long term energy supplies than what kind of investment return is achieved in the short term. Critically, these state sponsored companies have access to ultra cheap money, as a result of the financial support they receive from the Chinese government and they have shown no reservations about dealing with an aspiring nuclear terrorist. We have already noted the Pars field deal. In terms of access to low cost capital, as early as 2000 **Bank of China** was supplying US $2.4 billion in credits to **PetroChina** while **CNOC**'s blocked bid to acquire American **Unocal,** was backed by $18.5 billion worth of low interest Chinese government loans. An April 2006 **Carnegie Endowment** report notes:

"The Chinese government has given a blank cheque to improve China's energy security, the three giant state-owned oil giants - China Petroleum and Chemical, China National Petroleum and China National Offshore Oil - now have practically unlimited financial resources to make overseas acquisitions, regardless of economic viability or geopolitical risks".

Iran has the world's second largest natural gas reserves giving it a distinct geopolitical advantage when dealing with energy short Asian nations. Unlike Iran whose gas reserves are mostly undeveloped, most Western countries' gas reserves have been intensively developed for decades. As a consequence they have been rapidly depleting their gas reserves and will be increasingly forced to rely on Iran and Russia for new supplies.

The **EIA** estimates Iran has 940 trillion cubic feet (Tcf) of gas (approxi mately 16% of total world reserves) but it only produces 2.7 Tcf per year.

Putin & Ahmadinejad

Iran's huge energy reserves and their production growth potential make its nuclear energy and uranium enrichment plans patently unneces sary and highly suspect, as they can easily (and are highly likely to) lead to the production of atomic weapons. Already traces of plutonium, which could be used in a nuclear bomb, have been detected at one of its facilities.
The recent **UN Security Council** sanctions, which are meant to hamper Iran's development of nuclear weapons, have only increased the Ira nian nuclear program's domestic popularity, *and* its regime's defiance. Just after the sanctions were announced, Iran's parlia ment passed a law restricting the countries ability to cooperate with the **International Atomic Energy Agency.** Last week, Iran's President **Ahmadinejad** said "*If bullying powers ... want to resist (Iranians' will), we will give them a historic slap in the face*". And this is mild compared to his more usual rants about "*destroying Israel with nuclear weapons*", or attacking key Western interests with his fifty thousand "*suicide fighters*".

In response the US is continuing a major military build-up in the Gulf which we first highlighted last October. America is moving forward very carefully for good reason as any form of aggression could easily spark a wider Mideast war. In the words of **Iranian Expediency Council secretary Mohsen Rezai:** "*An attack on Iran will be tantamount to endangering Saudi Arabia, Kuwait, and, in a word, the entire Middle East oil*".

Last year **New Yorker** magazine's **Seymour Hersh** reported that: "*the Department of Defense was conducting covert reconnaissance raids into Iran, supposed ly to identify hidden Iranian nuclear and missile facilities that could be struck in future air and missile attacks*". In reaction the recent UN sanctions and an American naval build-up in the Arabian Gulf , Basiji commander **Gen. Majid Mir Ahmadi warned "***Iran could block oil shipments through the Strait of Hormuz in* *retaliation for imposition of international sanctions"* adding that "*the move would be specifically directed against U.S. allies in the region*. No wonder *"Fear of an emerg ing Shi'a crescent has been reflected in speeches by Egypt's President (Hosni) Mubarak, Saudi princes and clergy, and other Sunni Arab heads of states,"* according to **Mordechai Abir**, a senior Middle East analyst for **Burnham Securities**. And those fears have every reason to increase. According to the **British Daily Telegraph**, an unnamed senior European defense official says *North Korea has permitted Iranian nuclear scientists to study the results of Pyongyang's October 2006 nuclear test in order to assist Iran in preparing to conduct its own underground nuclear test*. The official said: *Iran could attempt to conduct its test by the end of the year.* Dubai based **Gulf Research Center** (GRC) says the **Gulf Cooperation Council** will not tolerate a nuclear Iran but sees a coming conflict between the U.S. and Iran as a "catastrophe". The **GRC** says that ""*Teheran has to finally realize that if push comes to shove, if the choice is between an Iranian nuclear bomb and a U.S. military strike, then the Arab Gulf states have no choice but to quietly support the U.S*.

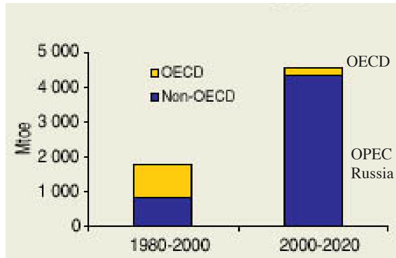
In reaction to these fears the Saudi's have begun a $60 billion upgrade of their entire military. Early January America dispatched another three am phibious assault ships. Three more warships are due to sail out of Norfolk for the Gulf two weeks ago, adding to the flotilla heading for the Gulf region (USS John C. Stennis strike group), or those already there (USS Dwight D. Eisenhower and the USS Boxer). Will there be a conflict? Hopefully not. Perhaps the better question is what sort of conflict will it be? Military or economic? Also worth noting is that 40% of the world's oil is transported past Iran and through the 34 mile wide, strait of Hormuz.

The Next Cartel

Will it drive long-term energy prices higher?

One way to exacerbate the effect of an anti-Western Iranian instigated embargo would be to form an OPEC- like ONGEC or **Organization of Natural Gas Producing Countries**. Unlike OPEC it would have a vir tual stranglehold on this energy sector. OPEC, The Organization of Pe troleum Exporting Countries was formed largely to maintain high oil prices but lost market control after a then Communist Russia began to flood the world market with cheap Siberian oil. Currently OPEC members together with Russia con trol about 4798 Tcf or 78% of world natural gas reserves. Canada and the US reserves total another 4.1% of world reserves, but like many of the remaining natural gas producing countries, they need all or most of the gas they produce.

The Dramatic Shift in Global Production Share



Source: World Energy Outlook
MTOE: million tons oil equivilant
One ton oil = 7 barrels oil

Consider that OPEC and Russia have 78% of the world's reserves and are the dominant gas exporters in what is one of the fastest growing energy sec tors. Is some sort of alliance or *Organization of Natural Gas Producing Countries* (which would act to keep prices high) the most probable outcome? India and China have been feverishly working to secure Iranian long-term supply. Energy hungry China, already has off-market long-term agreements with Iran covering at least 14% of its oil imports.

That does not include a just signed $100 billion, 25-year contract with Chi nese state oil company **Sinopec Group**, for the joint development of one of the **Yadavaran** gas field and the subsequent delivery of 250 million tons over that period of LNG to China. In response Iran is also buying products from China including a deal with **NORINCO** China's largest military con glomerate, to build Tehran's subway system.

While China appears to be in Iran's good books, Iran remains virulently anti-US and as detailed earlier, appears to have quietly joined a major Russian led effort to circumvent the US based oil trading market. Iran also no longer accepts US dollars as payment for the 2.6 million barrels of oil per day that it exports. This is of little consequence on its own. But critically, a growing amount of future oil and gas production is being tied up with off-market private long-term contracts. These state to state deals undermine the US dollar denominated global oil trading system's ability to effectively cushion supply shocks and prevent targeted embargoes.

So what are the possible outcomes? At best (and most likely) we should ex pect continued off-market deals that decrease the ability of the current oil futures market to absorb supply shocks and thus increased upward-biased volatility. Also probable is an at minimum tacit, Iranian – Russian coopera tion, that ensures gas prices stay at the highest levels, *they think,* Western economies can bear. And providing the Iranians don't get too ambitious regarding imposing their leadership on the Mideast, OPEC may join in to form part of a larger axis of Eastern energy states. If that occurs similar to the early 1970s, the West could once again be subject to targeted embargoes "*as the first phase*", every time a geopolitical conflict arises between it and the East. And those conflicts will most probably be within either the Iranian Shiite Crescent or the Russian sphere of interest. The real disaster will be if Iran manages to use its petro-billions to fudge its way into the nuclear weap ons club, and then lives up to its President's basiji fascist rhetoric.

The Far Easts' state-sponsored oil companies go shopping.

What does this mean and how can we make money?

We have already talked a lot about the re-ordering of our energy world as the rapidly growing East scrambles to tie up future oil supplies. But how can we make money from this trend? Critically, there is also a rush to buy outright, independent oil and gas companies as it is increasingly becoming the only way to grow reserves. And the advantage goes to the Asian state sponsored companies. Even **Warren Buffet** voted with his money when he bought a major stake in **PetroChina**. When China's **CNOOC** tried to take over America's **Unocal,** what it was really after was the growth opportunities arising from Unocal's Central Asian (Caspian) assets. In late 2005 another

highly revealing transaction occurred when China's **CNPC** bought Central Asian player, **Petrokazakhstan** for $4.18 billion.

This told us that Central Asia was definitely in play and that we should be looking for holders of major assets in the area as potential investment op portunities. Considering that it is in China's neighborhood we should expect the Chinese oil companies to get pretty aggressive in the future. Indian companies are also in the competi tion. For example last November **Mittal Steel**, (the world's largest steel maker) agreed to join Russia's **Lukoil** in a hunt for Central Asian oil assets. A month later the Chinese government's main investment arm, **CITIC Group**, joined the rush for oil by scooping up (for $1.9 billion) the 340 mil lion barrel **Karazhanbas field** in Western Kazakhstan. That oil-field was the principal asset of a Calgary, Canada based, private company called **Nations Energy,** which according to America's **Energy Information Administration** had invested $370 million between 1997 and 2005.

The Nation's Energy transaction demonstrates where big money is to be made in this mar ket – now and in the future. It was a near asset-less shell in 1996. It took an unknown but highly prospective Central Asian concession, financed its exploration and development privately for just under 10 years and then sold it for almost $2 billion dollars.

Nation Energy marks the second time in just the past 12 months that a Western junior oil company had its central Asian oil asset bought out by the Chinese. We expect to see more deals like this occur as nimble and very connected junior E&P companies acquire, develop and sell key Central Asian assets to (mostly) Chinese, Japanese and Indian major oil and indus trial companies.

The next giant Central Asian asset play?

Switzerland based, **Manas Petroleum Corporation** looks to be ideally positioned to capitalize on this trend. After four years of private develop ment at a cost of $7 million the company's November 2006 public debut was quickly followed by a $10 million financing most of which was taken down by its original shareholders, several Swiss Institutions and Canada's preeminent resource financier, Haywood Securities (Starmine ranks their head oil analyst #1). Manas has a highly connected executive, hall of fame (literally, as they have won awards) oil industry expertise, and a partnership with one of the oil industry's giants (**Santos**); while already controlling over 6,000 square kilometers (and growing) of ultra-prospective oil lands. Some of these lands *already contain oil fields*.

Manas really looks like a more diversified version of Nations Energy in its early days, in fact we think it could do even better.

The Company's principal areas of interest are the **Kyrgyz Republic**, (between Kazakhstan and China) and **Albania** (across the Adriatic sea from Italy). In the Kyrgyz Republic, where it has just over 3,000 square kilometers in the Fergana oil Basin, Manas already has 23 potential oil fields to be drill-tested. It also has Australia's third larg est oil company, Santos spending $60 million (including a $4 million signing bonus paid in cash to Manas) for an exploration and development program that consists of seismic and drilling . *Santos earns its 70% interest only when commercial production is achieved.*

Manas Chairman Heinz Scholz (fore-ground) and CEO Dr. Alexander Becker examine one of numerous, naturally-oc-curing streams of light crude oil at the Company's Tuzluk license.

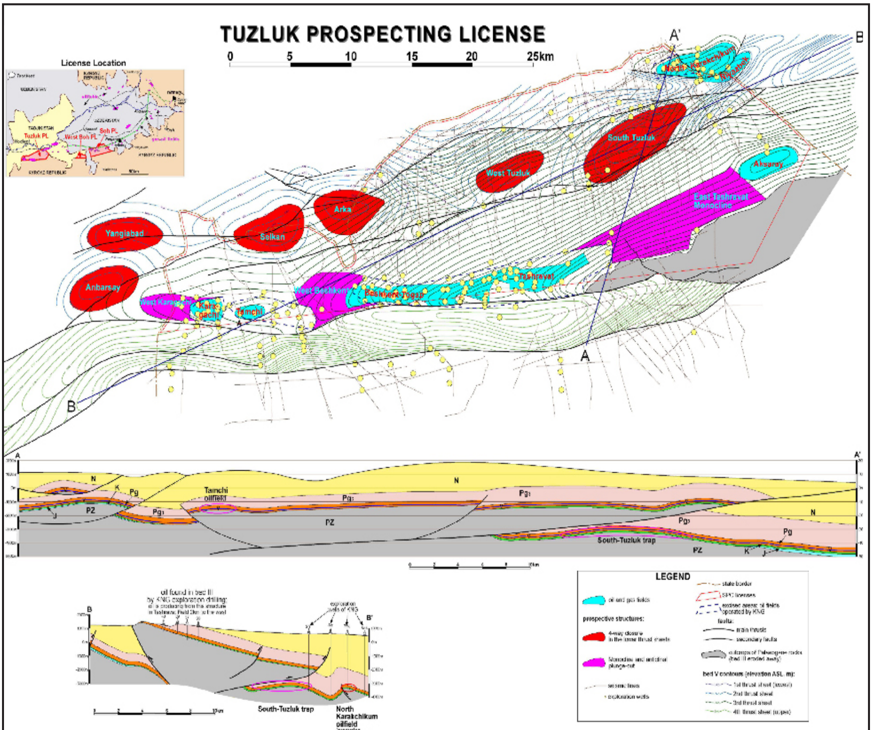
The Fergana basin shares the same geology as China's Tarim basin. The prin cipal difference is that when the Soviet Union collapsed the Soviets were just starting to drill the Fergana's deeper highly prolific structures. Following the collapse, all exploration and development stopped and the area has been in a near time-capsule ever since. The last Fergana oil field (**Mingbulak**) was discovered just at the tail end of the Soviet Union's collapse. It resulted in a blow-out which destroyed agriculture in the area.

As a telling indication of future possible production from these deep structures, subse quent wells from the field produced as much as 16,000 barrels per day.

To the Southeast (in the same geology and structural setting) in China's Tarim there was no political or economic collapse and they did not stop drill testing these deeper structures. *As a consequence, since the early 1990s, China's Tarim oil reserves have exploded from a few million barrels to 17 billion barrels.*

The same type of structures (under thrust) with the same geology where light low-sulfur oil literally flows on surface, are contained within Manas's

Manas Petroleum Kyrgyz and Albanian Interests



The above diagram is of Manas Petroleum's Tuzluk prospecting license. Note the location of the large seismically defined anticlines with 4 way closure (red) and the oil and gas fields adjacent (blue). (The areas with seismically defined mono clines and anticlinal plunge-outs are in purple) The cross section directly above left shows the South Tuzluk oil prospect (circled) one of many it is an anticline with four way closure and it dwarfs the 30 million barrel 300 Bcf gas North Karakchikum oil field only 3 km away on the right, which is tied in with seismic The S. Tuzluk probably holds 130-180 million barrels of oil) . A 1980s stratigraphic well actually penetrated the oil water cut exactly where it should have been: the down-dip portion of the under thrust anticline. The oil reservoir begins at the oil water cut and oil should fill the reservoir rock above it.

immense acreage. *Some of these potential fields are only two or three miles from existing oil fields.* When our chief analyst visited the Kyrgyz Republic, it became quickly apparent that Manas had acquired the Basin's best lands. He also found out that:

According to Kyrgyz government records going back nearly 100 years, every structure that has been drilled in the area has resulted in a discovery.

But how did they know where the best lands were? Years of experience and hard work. In recognition, Manas **CEO Alex Becker** was named the Republic's top mapping geologist 20 years ago, when the Soviets where identifying the locations of the area's yet-to-be-tested deep oil structures. He knows the area intimately, and even America's top experts agree with him regarding these structure's potential.

Prospective Resources and Risked and Un-risked Values for 10 of 23 known and developed Manas Kyrgyz oil prospects.

A 2,000 km seismic program is expected to begin immediately. It is designed to further define existing structures and to locate additional Mingbulak type structures and should further increase the NPV_{10} and EMV_{10}. The current Total Net Present Value from the risked oil reserves in the existing 10 structures is: **US $2.398 billion** and the Estimated Monetary Value is US $612 million assuming a 10% discount under a water injection scenario.

Scott Pickford
AN ECL GROUP COMPANY

Licence	Prospect	Unrisked Prospective Resources Best Estimate (MMbbls)	CoS (%)	Risked Prospective Resources Best Estimate (MMbbls)	NPV_{10} (US$ MM)	EMV_{10} (US$ MM)
Nanai	Alabuka -1	30.76	20.5	6.31	214.83	39.75
Soh	Burdalyk	110.25	23.0	25.36	781.75	177.03
	West Chaur	34.69	50.0	17.35	272.45	135.33
Tuzluk	South Tuzluk	36.62	23.0	8.42	287.87	63.44
	East Tashravat	25.33	32.4	8.21	73.84	61.45
Totals		237.65		65.65	1630.74	477.00

Secondary Targets

Licence	Prospect	Unrisked Prospective Resources Best Estimate (MMbbls)	CoS (%)	Risked Prospective Resources Best Estimate (MMbbls)	NPV_{10} (US$ MM)	EMV_{10} (US$ MM)
Nanai	Alabuka -2	21.20	12.8	2.71	147.71	14.20
	Alabuka -3	19.27	10.2	1.97	148.19	11.88
Soh	Kyzyl-Kurgan	43.50	23.0	10.00	304.63	65.91
Tuzluk	West Tuzluk	13.49	14.4	1.94	101.18	11.49
	West Beshkent	8.65	50	4.32	65.97	32.09
Totals		106.11		20.94	767.68	135.57

The ***United States Geological Survey*** *estimates that there remains 3.2 billion producable barrels of oil in the basin and that they should be contained in precisely the type of formations that have been identified on Manas lands.*

London based **Reservoir engineers Scott Pickford Ltd.** calculate *a potential 1.22 billion barrels in place with 622 Bcf gas from just 10 of the 23 structures so far identi*

An aging shallow oil field south of Manas Petroleum's Albanian deep light oil project.

fied. The engineering group also calculated the Net Present Values discount ed at 10% using a mountain of seismic and geological data including well studies. They came up with a NPV10 of US $1.63 billion which rose to $2.39 billion if water injection was used for production.
Clearly we expect to end up with a lot more than the 10 prospects that were the subject of the Pickford engineering studies. Although the results are already exceptional.

Albania: picking up where Shell left off.

While Manas's Kyrgyz assets on their own already appear to be company makers, the company has acquired another high-impact project but this time in Eastern Europe, between Greece (to the east) and Italy (west across the Adriatic). Manas Petroleum's latest major acquisition consists of four production sharing agreements in **Albania** covering just over 3,000 square kilometers**.** Similar to Kyrgyz Republic, Albania's economic and political problems have created what appears a superb opportunity for the company.

*According **Royal Dutch Shell** and **Corporex** calculations, Manas Petroleum's Albania holdings have a combined undiscovered reserve potential of 1 billion barrels recoverable.*

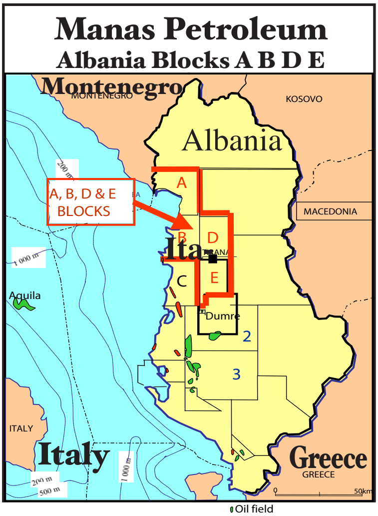
In the late 1990s **Royal Dutch Shell** and another much smaller company, **Corporex** spent $25 million defining, with state-of-the-art seismic, a giant under thrust structure 90 Km north of where a deep low-sulfur light oil (35 API) oil field existed. Further south of this field, several larger shallow fields produce high sulfur heavy oil. A Canadian company, **Bankers Petroleum** has been reworking one of the heavy oil fields in a small pilot *where results have exceeded expectations*. (We note that the Bankers' oil field equipment we saw was neither fenced off nor guarded - a far cry from the working conditions Shell experienced.)

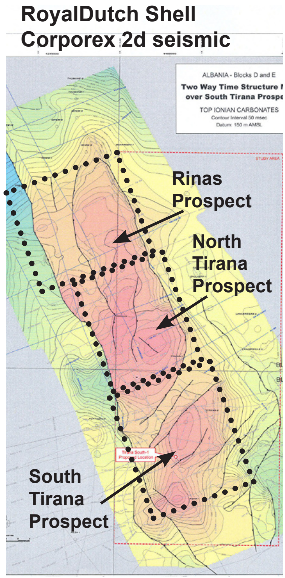
The principle risk of the Shell/Corporex project was not the structure itself or whether or not there was oil in the area. The principle risk was: what type of rock (thrust sheet) actually made up the seismically defined structure? At these blocks the Kyrja thrust sheet outcrops on surface. The Ionian thrust sheet, however, is what contains the targeted oil reservoir.

A discovery in 2005 by ***Occidental Petroleum*** *50 Km to the south of the Manas blocks establishes that the same deep section at the Manas blocks is very likely Ionian and that it should contain the same huge column (word is more than 600 meters) of oil.*

This is how Royal Dutch Shell measured the potential *prior* to the Occidental discovery:

Shell's estimate of the hydrocarbon volumes at its Rinas Prospect at the north end of the anticline was a recoverable 249 million barrels of oil 50 million barrels of condensate, and 2.5 trillion cubic feet of gas.





Corporex's estimate of the hydrocarbon volumes for its North and South Tirana prospects was that *"a producable 200 to 250 million barrels of oil and 2 trillion cubic feet of gas were contained in its South and North Tirana Prospects"*. The combined barrel of oil equivalent easily exceeds one billion barrels - making it one of the region's last remaining giant prospects. But despite the prospects' obvious massive size, in reaction to the collapse of Albania and the nearby Balkan civil war, both Shell and Corporex abandoned their holdings. Since then, The **European Union** has poured billions of Euros in a visibly successful effort to stabilize the country. Albania is expected to join **NATO** in 2008 and last June took a first step towards EU membership when it signed a **Stabilization and Association Agreement** with the EU. *Equity Research* was in Albania during November, analyzing the project and found the country to be upbeat and in the midst of a construction boom.

Last fall the **Albanian National Agency of Natural Resources** approved the main terms of a production sharing agreement with Manas for these lands. Final approval is expected within the next few weeks. In the meantime the company is working on acquiring major assets in Eastern Europe, Russia and Central Asia.

Clearly Manas Petroleum's Kyrgyz Republic (and subsequent $60 million farm-out) and Albanian acquisitions would be a brilliant start for any company. They are not however, content with just these two major assets. We think it is safe to expect that Manas will soon acquire other world-class assets owing to the efforts of its major shareholders who are also its Swiss, German and Russian executive.

Management

Knowing the backgrounds of Manas Petroleum's executive is understanding why they are likely to continue to succeeded in the economically ascendant East.

Chairman, Heinz Scholz, is an expert in the areas' politics and he knows many of the key players intimately. A physicist, and process engineer, in the 1980s, Dr. Scholz used to build factories across the former Soviet Union and Central Asia before its breakup. He even brokered the deal to sell the **Russian Military's** East German telecom assets to **Deutsch Telecom** at the time of Germany's re-unification. In that transaction *Dr. Scholz represented the Soviets.*

Manas **CEO, Alexander Becker** PhD. was one of Russia's top geologists during Soviet times (he was awarded Best Mapping Geologist in Kyrgyz Re public in the 1980s) and later received the coveted Peres Greder award for his geological research. *Dr. Becker has already discovered two oil fields in the For mer Soviet Union.*

CFO Peter-Mark Vogel is a member of the **Swiss Society of Investment Professionals**. When he left the banking Industry as a **Senior Analyst** for **Bank Sal Oppenheim** to help start the company he was *rated number two in the industry for the performance of his recommendations.*

UK based, **Chris Pitman** is one of the company's founders and is the **Geological Advisor to the Board**. He is an expert oil field reservoir engineer. As the Managing Director of **Energy Advisors Limited,** he advises such oil field finance giants as **BNP Paribas** and the **Abu Dhabi Investment Company.** He was a **Director of Business Development of Schlumberger Geoquest.** He has an Advisory Mandate to **Mohamed Al Fayad** (owner of Harrods of London) and has been an expert advisor to **The World Bank.**

In summary, we view Manas Petroleum as an excellent speculative investment. It already has some exceptional assets on its books and the ad ditional credibility that comes with its $60 million partnership with oil giant Santos. Aside from this, Manas is also amply financed, and has manage ment which not only are politically connected, they are among the world's leading experts in their specialties. They also are aggressive players who plan additional high impact acquisitions. *In short not only does Manas have deal quality, deal flow and deal diversity, but we speculate, that it should also have a steady stream of news that is likely to drive its shares considerably higher.*

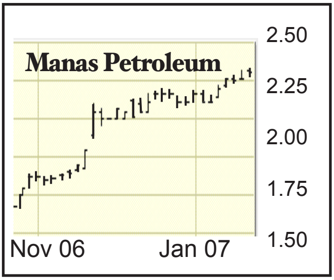
A Sinopec well near Manas Petroleum's Kyrgyz licenses.

There is a certain wow factor that is felt when see ing its projects. It is almost as if the Soviets had put the Manas's FSU and East-European assets in a time capsule for its management to open in 2006. The area, with its apparent untapped potential, reminds us of historical accounts of East Texas at the turn of the century, except we have modern technology with which to explore and develop these obviously oil saturated prospects.

With its prospective acreage covering 6,000 square km, Manas already has assets that make it a very attractive takeover target, considering the ongo ing global scramble for what few giant hydrocarbon assets remain. We doubt management would agree to a take-over mainly because they expect to dramatically increase the value of what they already have, never mind what they have in their sights for the future. We expect Manas to grow very quickly via acquisitions and by the drill bit and we rate Manas an overweight speculative buy.

Quick Facts:

Manas Petroleum (NASD OTC: EXPY) publicly traded: November 2006, after filed reverse takeover of Express Systems (symbol & name change pending) only notable trading pattern, is its clear uptrend. Our read of the situation is that its shares are likely to remain in this uptrend as the company continues to develop and its story becomes better known.



Share structure

***Free trading shares**: 6 million, **Financing**: 10 million units. Each unit consists of 1 share and 0.5 share purchase warrant exercisable @$3.00 and 0.5 share purchase war rants exercisable @4.00. Hold peri od one year (Jan 2008). **Escrowed**: 14 million restricted from trading until October 2007. **Management owns**: 52 million shares of 76 million that are escrowed and pooled until June 2008 after which no more than 3% can be sold every 90 days. **Employee and directors options**: 10 million exercisable at $4.00 per share*

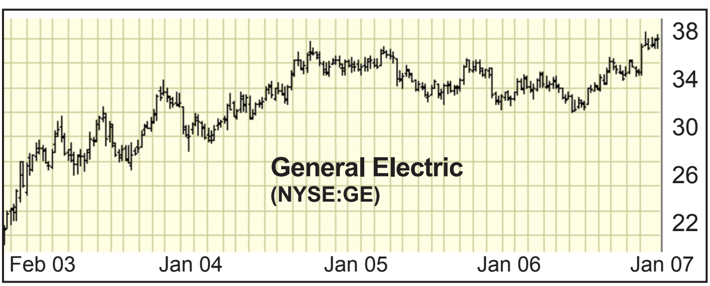
Financial

***Cash**: $11 million cash, **Debt**: none **Development Exploration Farmin:** $60 million Santos. **Asset Valuations**: $1.630 billion or (adjusted for Manas carried interest) $4.30 per share risked Net Present Value (NPV10) for first 10 of the most developed prospects on its Kyrgyz Republic licenses – Expect this to increase as work progresses. Current (Scott Pickford) financial valuation of Albanian assets due by the second quarter. Santos farmin program to begin immediately. For copies of the report or more information please go to Manas Petroleum's website at **www.manaspetroleum.com**.*

Roll call: the last eight years of mergers and acquisitions.

As the Harrison Lovegrove study showed; attractive exploration and development opportunities are diminishing rapidly. In reaction the majors have increase dividend payouts and bought back $ billions worth of their shares. They have also been buying their competitors providing that they still have substantial, high quality exploration and development inventories. Below are the last 8 years of the most notable mergers and acquisitions:

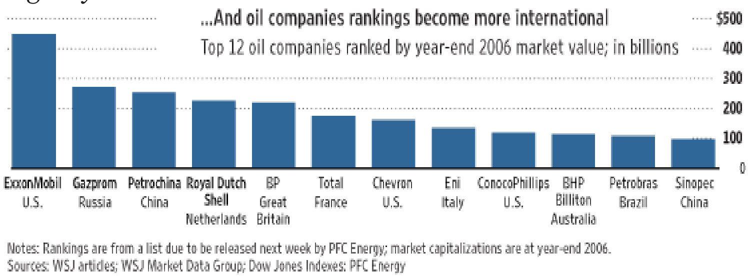
December 1998, BP buys Amoco. December 1999, Exxon and Mobil merge. April 2000, BP-Amoco buys Arco. October 2000, Chevron and Texaco merge in a deal worth $90 billion. November 2001, Phillips buys Conoco merge; the deal's value: $15.4 billion. April 2004, Westport Resources buys KerrMcGee for $2.5 billion. April 2005, After Sinopec bid is blocked, Chevron-Texaco acquires Unocal for $16.8 billion and gets its prized Caspian assets. June 2005, Royal Dutch Petroleum buys Shell Transport and Trading for $80.3 billion. July 2005, Total Fina buys Elf Aqitane for $56 billion. December 2005, Burlington Resources buys Conoco Philips for $36.5 billion. June 2006, Anadarko buys Kerr McGee $23 billion. December 2006, Statoil merges with Hydro, deal's value: $28 billion.



General Electric is one of America's most admired companies and is ranked 5th on the Fortune 500 (in terms of revenues). GE has just made a big bet on the oil business, just as oil's price was reaching two year lows (page 12).

Out of nowhere

A decade ago state-sponsored publicly-listed energy companies were tiny or they did not exist at all. Now just the 50% of Gaz prom, that the Russian government doesn't own, makes it the world's second largest listed company. Upstart Petrochina is third and Sinopec #12th and growing. This does not include the many billions of barrels in reserves controlled by 100% state owned companies such as wholly Chinese government owned CNNOC as if they were included in aggregate, most Western Companies would not make the chart. *Significantly, if 100% state owned compa nies are included (and ranked according to reserves), Exxon Mobil would move down from being the largest privately owned oil company to 14th largest by oil reserves.*



Please always do your own research. For example the internet can be a powerful tool. You may easily check insider sales via Yahoo finance or use search engines to learn about a com pany, its principles or industry. Do this and only invest in what you understand. As always, it is essential as investors that you should individually make your our own judgements as to the appropriateness of any securities discussed herein. No statement or opinion or any matter herein, directly or indirectly is an offer or a solicitation to buy or sell any of the securities mentioned. The information contained herein is from sources believed reliable but we do not guarantee its accuracy. Please assume that the writers, analysts and all employees and principals of Equity Research, The Swiss Research Group, may and often do buy and sell the securities mentioned herein. This report is written exclusively for Equity Research, The Swiss Research Group and may not be reproduced without the written permission of Equity Research, The Swiss Research Group. It is owned by Equity Research Partners GmbH a completely independent analytical group based soley in Switzerland.

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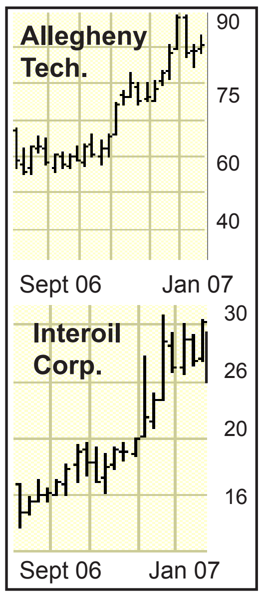
FOURTH QUARTER FLYERS

We upgraded **InterOil Corporation** (AMEX:IOC $25) from a buy to a **speculative *overweight* buy last October** 31st based on its strong technical picture and our expectation that the market's recognition that the company had made a giant natural gas discovery was about to be built into the share price. Its shares had been slowly working their way up from a $12 summer low and subsequently rocketed from $19 to $30 in reaction to results at its Elk #1 discovery well in Papau New Guinea. The initial estimate is that the discovery has recoverable reserves ranging from 2.5 Tcf to 11.3 Tcf. Also worth noting, the well's high volumes of condensate increase the chance that a deeper oil section will be encountered. This would be typical for the area given that all seven of Papau New Guinea's oil fields have significant gas caps. As drilling continues and a clearer picture of the actual reserves is obtained we expect its shares to move higher. We also expect improved results from the company's refinery as it begins to produce higher margin products. Its Merril Lynch LNG partnership should also provide positive news. When its shares ran up to $30 we did reduce our weighting from overweight buy to underweight buy. Given the high probability that the oil market correction is near-complete and that we expect this story to continue to build (and its shares to do considerably better) we are increasing our weighting to buy at $25.



Equity Research recommended the $4.4 billion revenues, **Allegheny Technologies** (NYSE:ATI $88), early October 2006 as a **conservative overweight buy at $63**. Since then the world's largest high-tech metals maker has been on a tear. The specialty metals maker has increased its quarterly dividend by 30% to $0.13 per share last December. When Allegheny reported a $2.5 billion contract to sell titanium products for Boeing's Dreamliner, its shares' up-move accelerated. We continue to own the company's shares for their long term capital appreciation potential as the company continues to experience excellent growth in the offshore and aerospace specialty metals sectors. In reaction to its sharp gains we reduced our exposure and rating from Buy with an overweight position, to Buy neutral weighting.