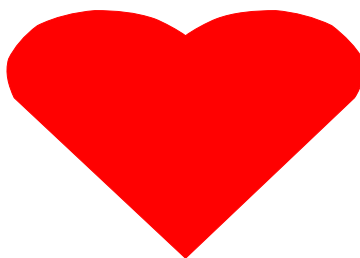

The Odd Couple

*The Adventures of a Heavily Indebted Poor Country
&
its Transnational Sugar Daddy*

Match Made in Heaven?



Veronica Maddocks

Aran Kim

Laura Tran

Stan Valov

Yessy Liang

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I. EXECUTIVE SUMMARY

Subject

Situated 143 miles off the coast of West Africa are two islands, Sao Tome & Principe. Together they form one of the poorest, smallest and least known independent states in the world. However, an unexpected turn of events in 1997 led to the discoveries of oil reserves in its territorial waters. In 1998, Exxon Mobil signed an agreement with the country to explore 22 of its deepwater concession blocks. The reserves are estimated to hold about 4 billion barrels.

Issue

This case will be written from two different perspectives: (1) of a Heavily Indebted Poor Country (HIPC), Sao Tome & Principe and (2) of a transnational corporation, Exxon Mobil. Although they have shared interest in oil revenues, Exxon Mobil's motivations and objectives regarding these revenues will be very different to those of Sao Tome.

Value to Students

Note: the continent of Africa is traditionally dismissed and neglected by western countries and firms. Too often the region has been associated with pictures of civil unrest, starvation, deadly diseases and economic disorder, leaving many investors with negative perceptions of Africa as a whole. While this perception is not based on fiction, as in some countries these unfortunate conditions exist--it is not the true picture of the majority of African countries. We believe this region deserves a closer look, as it is positioned to become the next major global player.

While this paper's specific focus lies in the region of Sao Tome & Principe, it offers students the unique perspective regarding the process of transitioning the economy, as they evolve from a developing to emerging market. Lessons from the case are not restricted to the continent of Africa, but can in fact be easily applied to similar global markets.

- Understanding the unique risks, challenges and opportunities that exist in developing and transition economies
- Value the project using Net Present Value
- Implications of debt in developing and transition economies
- Understanding the political and economic issues surrounding privatization
- Issue of transparency in partnerships between domestic governments and MNC's
- Recognizing/identifying essential macroeconomic factors required for potential foreign direct investment/investors
- Recognizing/identifying economic sectors in developing/transition markets which offer tremendous potential growth and return
- Understanding the geopolitical implications of the oil industry

II. CASE STUDY

Background

Introduction

Located off the western coast of Africa, Sao Tome & Principe is one of the poorest, smallest, and least known independent states in the world. It is recognized by the IMF and the World Bank as a Heavily Indebted Poor Country (HIPC). In contrast, U.S.-based Exxon Mobil is one of the world's wealthiest and largest integrated oil companies, with a market value estimated at US\$306.67 billion. The 1997 discovery of oil reserves in the territorial waters of Sao Tome resulted in the unlikely partnership between these two parties. Although they have shared interest in oil revenues, Exxon Mobil's motivations and objectives regarding these revenues will be very different to those of Sao Tome. The case will provide insight into each party's unique point-of-view on this collaborative project.

Underlying Issues

Projected Revenues of Sao Tome Territorial Waters

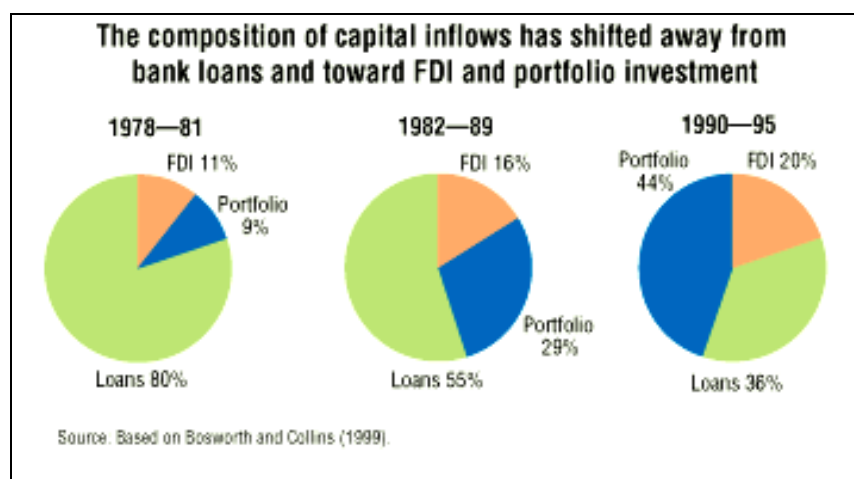
In 1998, Exxon Mobil undertook a seismic study of the island nation's territorial waters and revealed exploitable reserves estimated at 4 billion barrels. Even at the extremely reserved price of US\$10 per barrel, US\$40 billion represents an enormous amount of wealth for Sao Tome & Principe. In a perfect world, one would think that the sudden influx of money would solve a country's economic, social, and political problems. However, in reality this is not the case when there are opposing parties involved. This is the situation Sao Tome is currently experiencing with Exxon Mobil.

JDZ Agreement (Appendix G)

Sao Tome & Principe's chief collaboration is currently with Nigeria. Oil cooperation between the two countries has led to a widening of mutual relations and Nigeria has offered aid to Sao Tome & Principe in the fields of education, transport, and finance. In addition, a benefit of the agreement is that Nigeria will train officials of the country in the technicalities and business of oil management, and it will help Sao Tome & Principe construct an oil refinery and build a deepwater port.

FDI

Foreign Direct Investment (FDI) is defined as the direct [investments](#) in productive [assets](#) by a company incorporated in a foreign country. In the last decade of financial crises, FDI has proved to be resilient. For example, during the Asian financial crisis in 1997-98, East Asian countries experienced remarkably stable investments. The resilience of FDI was also evident during the Mexican crisis in 1994-95 and the Latin American debt crisis in the 1980s. This resilience could lead many developing nations to favor FDI over other forms of capital access. In the chart below, it is evident that recent trends show the preference of FDI over other forms of private capital inflows.



Even though economic theory and empirical evidence suggest that FDI has beneficial impact on developing host countries, recent studies show that there are some potential risks that can reverse benefits through financial transactions and excessive leverage.

Corruption & Transparency

Corporate transparency is crucial in addressing the issue of corporate corruption and reducing the potential for illicit transactions with public officials. The problem with undisclosed payments to foreign government stems from faulty accounting principles, which allow companies to file a single set of amalgamated accounts for their worldwide operations. Since this information is not required to be broken down, firms rarely provide information on tax and other payments to individual countries. Under current accounting rules, it is therefore impossible for the public to calculate how much money is paid to foreign governments. Improving standards of financial reporting will help expose corruption in countries where there is little or no access to government financial information. In these countries, the disclosure of financial information and legitimate payments may be the only effective way of calculating the real level of project revenue. Possible approaches to improve financial reporting include the following: regulation, voluntary guidelines, awareness raising campaigns, managerial training, internal controls, and incentives to ensure corruption is monitored.

Government

Instability and political infighting has been a familiar fixture of Sao Tomean politics since its democratic rebirth in 1991. Its current constitution and the three-party system have not yet matured to a level sufficient to make for a trouble free efficient federal system. Overall, Sao Tome & Principe has been laden since its inception with power struggles between the president, the government, and the principle parties and it has also been burdened with widespread corruption. Recent debates discuss the ambiguity of the national constitution and presidential power. Thus, the actions of current President de Menezes have been a constant source of frustration for the National Assembly.

This instability is a detracting factor to outside investors looking to tap the rich oil fields of its national waters. It can also prove to be a debilitating factor towards improving the overall condition of the country, as resources are squandered due to inefficiency and instability.

Because Sao Tome is a “small country playing a big country’s game”, it encounters the risk of being bullied by other nations. With a national military composed of 300 soldiers (half of which comprise the Presidential Guard) and no existing Air Force or Navy it will remain difficult for the country to protect its borders as well as its interests. It is in constant fear of being forcefully invaded by Nigeria,

who is Africa's largest state and its biggest oil producer as well as Sao Tome's partner in the JDZ. To that extent, Sao Tome & Principe has been looking to building relationship with more powerful nations that could possibly protect it, or at least exert influence in the region in its benefit. Sao Tome & Principe has had talks with both the French and the US for closer military ties. These talks have resulted in the US providing military training to the poor island nation; there was even a talk of a US military installation in the country to protect its assets in the region. Political instability within the nation plays an important role in the safety of the country, as outside firms and nations try to influence the unsure government in their favor.

SÃO TOMÉ & PRÍNCIPE



ATLANTIC OCEAN



To Príncipe (150km)



© Lonely Planet

Sao Tome & Principe Perspective

Foreign Direct Investment

Economic Performance

Sao Tome & Principe is home to the world's poorest people, with a gross national income (GNI) per capita averaging approximately US\$280 from 1997-2001 (Appendix A, Graph 1). Sao Tome's GNI per capita has been low, yet stable and flat throughout the past five years. The country's poverty is further magnified when compared to other emerging markets such as China and Thailand, which have GNIs per capita around 7-10 times that of Sao Tome.

According to the World Bank's *Global Development Finance*, Sao Tome's total external debt is estimated to have reached US\$316million in 2000, of which US\$294million was long-term public and publicly guaranteed debt. The island nation's debt had long been unsustainable, with total external debt equivalent to 2,273% of exports of goods and services and 726% of GDP in 1999. Moreover, Sao Tome & Principe has been unable to service its external debt and has had to depend on concessional aid and debt rescheduling. In December 2000, Sao Tome & Principe benefited from \$200 million in debt relief under the Highly Indebted Poor Countries (HIPC) program, thus eliminating a large slice of foreign debt.

Creation of Economic Duty-Free Zone

Purpose is to build a servicing facility for offshore oil drilling platforms and facilities for rest and recreation for platform workers within the duty-free zone. Expected benefits from the zone include the following:

- Hong Kong-like Customs duty exemptions and simplicity of business registration
- Elimination of taxes, commercial governmental monopolies, and wage and price controls
- Swiss-style banking and relief from foreign exchange controls
- Free market provision of telecommunications and port operations, airport support services, basic infrastructure and utilities, and residential, health, education and recreation facilities

Businesses seeking a base of operations in the region can enjoy safe, stable, and competitive operating and living conditions in an island setting offering high quality of life. The service sector will also benefit from the free zone advantages, which will extend to education, health and other professions.

Sustainable Development

Sao Tome & Principe expects the development of its oil reserves to spur the economy by means of Exxon Mobil. The company's direct foreign investment implies the creation of pipeline jobs for the local population, as well as the transfer of managerial know-how and technology. Understandably, the nation looks forward to benefiting from the increased labor skill and technology advancements, which will then make FDI an increasingly attractive option for other developed nations. However, anticipating these benefits and attempting to quantify them may be incorrect and imprecise. Consider previous Exxon Mobil projects in this region where oil extraction utilized 100% imported technology, and whose workforce was comprised totally of expatriate employees. Additionally, the offshore drilling would not be easily accessible by the local population, which misrepresents the notion that the

new oil industry will bring new jobs to locals. If this pattern for oil development is true in Sao Tome, then there will be no significant effects in terms of resource demand for the local economy, since Exxon Mobil will use almost no domestic capital, labor, or even consumption items for its work force.

Improvements to Infrastructure

Revenues from oil production should largely be used both to advance the country's infrastructure, and to promote and expand new and existing industries rather than relying solely on the young and booming oil business to sustain the country. By developing its infrastructure and diversifying sectors of its economy, Sao Tome & Principe could reduce its dependency on imported goods, at the same time increasing its exports and services. This will help to balance the country's large trade deficit. However, diversification cannot be successful until extensive infrastructural improvements are implemented.

Economic Diversification

Because oil is a finite resource it is important to recognize that although the oncoming oil boom will be large, it will not be permanent. In addition, the domestic economy is dependent on cocoa exports and it encounters severe terms of trade shocks due to the volatility of the global price of cocoa. Therefore it will be vital for the country to make investments towards its long-term prosperity by way of a revenue base unrelated to oil. To reach this goal, Sao Tome & Principe should encourage development and growth of other sectors in the economy. Evidence for sector diversification can be found during 2000 and 2001 where the GDP grew by 3%, (in previous years GDP growth had remained stagnant). This was due to construction activity related to the development of oil, shipping, and tourism sectors which helped to offset the effects of fluctuating cocoa prices (Appendix A, Graph 2). By capitalizing on existing comparative advantages as well as taking steps to promote new ones as well, current and future economic imbalances can be remedied. However the success of this upcoming diverse economy hinges on much needed improvements that must be made to the country's current, poor infrastructure.

Joint Development Zone (JDZ) Agreement

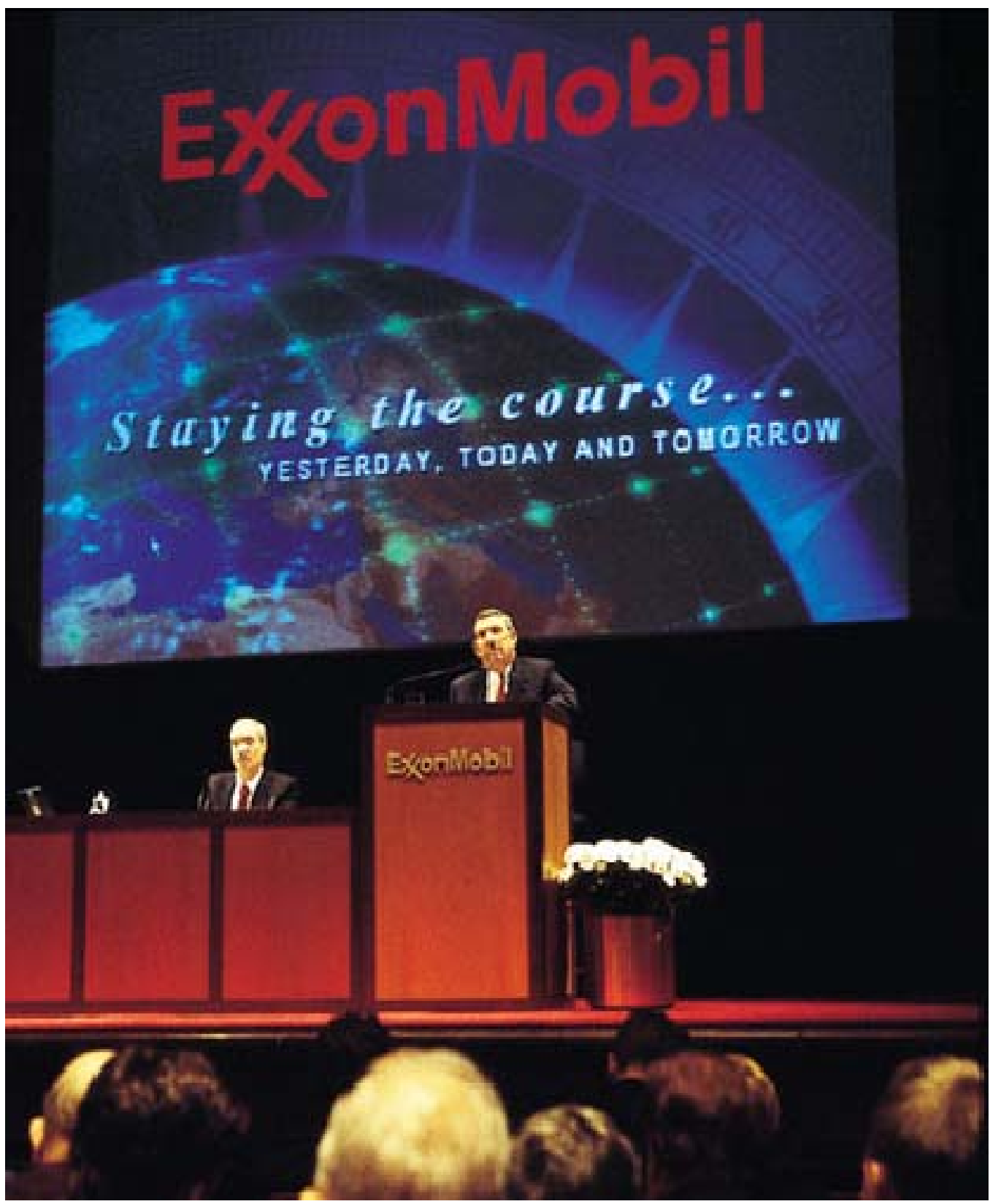
Nigeria and Sao Tome signed a treaty setting up the JDZ, giving Nigeria a 60 percent stake of the crude oil in the zone while Sao Tome and Principe is entitled to 40 percent. The treaty was agreed upon by Sao Tome's former president, Miguel Trovoada. The current president, de Menezes, is contesting the validity of the contract seeing as it only grants Sao Tome a minority claim in the crude oil.

Government Transparency

Transparency is essential to reduce the potential for illicit dealings with public officials and to promote transparency in public accounts where governments do not provide it. Improving standards of financial recording can help to expose public sector corruption in countries where there is little or no access to government financial information. In such countries, the disclosure of information about legitimate corporate payments to the government may be the only effective means of finding out the real level of public revenue.

ExxonMobil

Staying the course...
YESTERDAY, TODAY AND TOMORROW



Exxon Mobil Perspective

Company Profile

Exxon Mobil is the world's largest integrated oil company. The company engages in oil and gas exploration, production, supply, transportation, and marketing around the world (Appendix B, Exxon Mobil Business Structure). It has proved reserves of just less than 21 billion barrels of oil equivalent. The company supplies refined products to more than 40,000 service stations in 118 countries that operate under the Exxon, Esso, and Mobil brands. With major oil and gas holdings in Europe, the U.S., and Eastern Canada, the company is looking for new opportunities in West Africa, both onshore and off; in the former Soviet Union; and in South America. Exxon Mobil produces and sells petrochemicals (including ethylene, olefin, polyolefin, and paraxylene) and mines coal and other minerals. It also has stakes in electric power plants in China. Currently, Exxon Mobil's portfolio consists of discovered oil and gas resources of 70 billion oil-equivalent barrels, activities in some 50 countries, and a leading acreage position in the world's most promising exploration areas. The company invests nearly US\$200 million a year in upstream research. The company's favored performance benchmark is the ROCE (return on capital employed) multiple. The company has always maintained a modest 2-3% growth goal while emphasizing the delivery of industry leading financial returns through capital discipline and portfolio rationalization (Appendix B, Exxon Mobil Current Project Activities).

Current Activities: Sao Tome and Principe

Exxon Mobil estimates Sao Tome is sitting on reserves of perhaps four billion barrels of crude oil. Seismic studies indicate deposits lie under the ocean floor in depths ranging from twenty-four hundred to nine thousand feet. In March 2000, Exxon Mobil and the Government of Sao Tome signed the "Technical Cooperation Agreement" which gave the company the rights to offshore blocks 1 to 22 (Appendix B, Exxon Mobil Off-shore blocks). However due to subsequent border and contract disputes between Sao Tome and Nigeria, the company has been forced to delay exploration. Additionally, the current Sao Tome president, Fradique de Menezes recently voiced that he wants to renegotiate the contracts signed under his predecessor Miguel Trovoado with Exxon Mobil. This would significantly change the company's future market position in this region as well as have implications for our project valuation.

Net Present Value of Sao Tome Oil Reserves

	D	E	F	G	H
1	Projected Cash Flow Analysis				
2	Sao Tome Oil Reserves				
44	Year of Analysis: 2003				
45					
46	Year	2006	2007	2008	2009
47	Barrels Per Day	25,000	42,175	71,149	120,000
48	Historical Average Price Per Barrel	\$20.56	\$20.56	\$20.56	\$20.56
49	Pumping Days Per Year	365	365	365	365
50					
51	Projected Oil Revenue (per annum):	\$187,591,750.00	\$316,467,282.25	\$533,878,616.83	\$900,440,400.00
52					
53	Present Value Of Oil Revenue:	\$146,915,053.60	\$228,454,071.00	\$355,246,764.93	\$552,280,994.62
54					
55	Discount Rate:	8.49%		* - The cash flows for these years were back to 2003, and finally summed unde	
56					
57					
58	Total Project Investment				
59	Estimated Average Cost of Sao Tome Reserves	(\$5,867,076,481)			
60	Project Investment Cost relies on the assumption that a \$3.4 billion investment is capable of recovering 1 billion barrels of oil, based on comparable projects in the Western Region of Africa. It is assumed that Exxon Mobil will reinvest \$3.4 billion at equal time intervals during the life of the project to successfully complete the recovery of Sao Tome's reserves.				
61					
62	Net Present Value of Sao Tome Project:	\$2,634,179,519.27			
63					
64	Exxon Mobil Share NPV of Project:	\$1,053,671,807.71			
65	According to the terms defined in the Agreement between Sao Tome and Exxon Mobil, where Exxon Mobil receives 40% of the earnings, and faces all costs.				
66					
67	Source: EIU Country Profile 2003				
68	Source: ExxonMobil 2001 Financial and Operating Review				

(Appendix E)

According to the JDZ agreement, Exxon Mobil and Sao Tome's combined 40% stake in the oil reserves is equivalent to approximately US\$1 billion. Although the exact terms of the agreement between both parties are not disclosed, we can assume that with Exxon Mobil's estimated project investment cost of US\$6 billion will still result in a positive net present value.

Current global market trends indicate that the new high potential opportunities are located in deepwater areas (i.e., in excess of 1,350 feet of water). Sub-Saharan Africa currently has output of more than 4 million barrels per day (BPD), producing as much as Iran, Venezuela, and Mexico combined. Also, this area has experienced greater growth in addition to an increase in oil output in the Sub-Saharan region (up to 36% in 10 years), as compared to other oil producing countries that had an output of only 16%.

Corruption and Transparency

The oil industry is known for its use of bribes, also known as signature bonuses. In 1973, Gulf Oil admitted to funneling over US\$10 million to US and foreign politicians. When the Securities and Exchange Commissions responded to American corporations in a questionnaire regarding bribery, more than 400 corporations, including oil companies like Exxon, acknowledged making questionable payments to foreign government officials, politicians, and political parties. As a result of this, the Foreign Corrupt Practices Act was passed.

III. TEACHING NOTES

Sao Tome & Principe Perspective

Foreign Direct Investment

Economic Performance

Since its independence from Portuguese rule over 25 years ago, the economy of Sao Tome & Principe has been highly dependent on plantation agriculture, which accounted for 20.5% of GDP and approximately 90% of exports in 2000. In particular, the country is highly dependent on cocoa production, which accounted for over 60% of export earnings in the early 1990s. However, economic performance has been hampered by volatility in the cocoa industry. Drought and mismanagement has led to a substantial decline in cocoa production causing a shortage in cocoa export. Falling international price of cocoa further reduces the value of cocoa exports as well. As such, Sao Tome & Principe's reliance on such a volatile commodity as essentially its only export product has made the country very vulnerable to declining cocoa prices and rising prices of energy, food, and consumer and capital goods, resulting in large balance-of-payments deficits. Due to the fact that export crops dominate the country's agriculture, 90% of the country's food must be imported. From 1997-2001, Sao Tome & Principe suffered large balance-of-payment deficits that were as high as 60% of GDP (Appendix A, Graph 3). The country also imports fuels, manufactured goods, and consumer goods.

Regardless of the amount of expected oil revenues, Sao Tome & Principe's tiny economy will be flooded with an inflow of hard currency. While the dobra (national currency) is currently stable with an exchange rate of 9000 dobras per US dollar, it is widely speculated that the currency will appreciate as a result of oil revenues/exports and balance of payment surpluses. The ratio of debt-service to exports has declined from over 35% in 1998 to less than 30% in 2000. Even though Sao Tome & Principe's total debt-service is much higher than other emerging markets' debt-to-export ratio, the World Bank forecasts that Sao Tome's debt-service to exports ratio will fall from 29% in 1999 to 7% in 2000-2009. This reduction in debt-service payments will free resources giving the country more economic and financial flexibility in the future.

It appears that, as of date, Sao Tome is using their oil revenues wisely. The Finance Minister, Maria de Torres Tebus, recently acknowledged that the "money earned by the country during the prospecting study entered the state coffers and the majority was used to pay the country's foreign debt". Thus, Sao Tome & Principe shows signs of commitment to reducing the nation's debt. It is to Sao Tome & Principe's benefit to repay their loans to establish creditworthiness, as well as attracting foreign assistance. Successful implementation of the World Bank's and IMF's structural adjustment program has resulted in the approval of a three-year poverty reduction and growth facility (PRGF) in April 2000. Through the PRGF, the government is committed to pursuing tight monetary and fiscal policy, reducing inflation, increasing budgetary allocations to social sectors, and carrying out structural reforms that will promote economic growth.

Economic expansion has long been hindered by macroeconomic instability. Heavy state interference, widespread corruption, weak institutional performance, and dependence upon a single export crop (cocoa) have led to an average real GDP growth of just 1 percent in 1985-95. Growth began to rise slowly in the late 1990s and early 2000s, with GDP reaching 2.5% in 1998 and 1999, and 3% in 2000 and 2001 (Appendix A, Graph 2). The recent economic expansion is due to improved economic policy performance and a large inflow of foreign assistance, thus further proving Sao Tome's progress.

Foreign Exchange and Currency

Although oil revenues will not be realized until 2006, the dobra will begin appreciate due to increased oil investments in the nation. When the dobra appreciates with the onset of oil exploration, inflation is also expected to increase, driving up the relative price of goods. Since Sao Tome & Principe's economy relies so heavily on importing foodstuffs, fuels, manufactured goods, and consumer goods, it would be in the country's interest to maintain a properly valued currency, as the dobra's appreciation may cause significant changes in the relative price of goods in the economy. In addition to increased inflation, currency appreciation also leads to an increase in consumption and a decrease in production of traded goods, resulting in the stagnation of domestic traded goods, which increases balance of payment deficits. Thus, Sao Tome & Principe needs to monitor the effects of oil revenue on the national currency because of its impact on the nation's economic well-being.

Creation of Economic Duty-Free Zone

This ambitious project has made little progress, and there are serious doubts to whether it is viable and whether it is even desirable, given possible environmental and socio-cultural effects. It might very well destroy the unspoiled beauty of the island, thus inhibiting the potential of other industries such as tourism. Consequently, it would seem that other options should be further investigated in order to avoid such problems.

Sustainable Development

Sustainable development depends on three interrelated elements: economic, environmental, and social. Upon implementation, infrastructural changes and advancements will provide Sao Tome with a strong base upon which it can expand its economic sectors, thus leading to its ultimate goal of diversifying its economy.

Improvements to Infrastructure

- Highway System

Sao Tome's chief infrastructural problem lies within its road system. The island, which has an area of over 1000 sq km., has only about 300 km of roads. There is a main highway that runs along the coast of the island connecting its four main towns. In addition, there are two that run from the eastern and southeastern coasts respectively into the heart of the island. The remaining one-third of the country's roads are unpaved. The lack of modern road systems make navigation around the country very difficult because not all parts of the island are accessed by these roads, and a large part of the existing roads offer course and rough driving conditions. In order for any sort of extensive commerce to function successfully in Sao Tome, its infrastructure must be built from the bottom-up, beginning with a modern road system that will allow farmers, tourists, and inhabitants to easily travel from one corner of the island to another, thus facilitating local trade and tourism.

- Port System

The island of Sao Tome currently has one major port, in addition to a smaller port located on Principe. The lack of a deepwater port on the two islands is a direct impediment to the import/export business and it contributes to the consistent trade deficit. Large deepwater vessels, which are responsible for the country's imported and exported goods, are forced to dock off of the coast of the island. The cargo is then transported to and from shore by a smaller vessel that can function in the shallow water, causing the loading and unloading process to be done twice with each transaction. As a result, valuable cargo is often damaged or dropped overboard and such damages and losses must then be absorbed by the Sao

Tomeans conducting the business. Because of Sao Tome & Principe's heavy dependency on imports and the money that they receive from exports, it is extremely important that this issue be addressed. With oil revenues, Sao Tome & Principe should invest in the R&D for a new deepwater port or for the development of a more efficient and effective way to load and unload the ships.

- Merchant Marine Capabilities

Another issue that affects Sao Tome & Principe's imports and exports is its lack of domestically-owned ships in the merchant marine sector. As of 2002, it had 41 ships in its port, although this included a number of foreign-owned ships registered there as a flag of convenience. Among these ships, 29 are for carrying bulk products and cargo and the remaining minority is an assortment of petroleum and chemical tankers, livestock carriers, and a few specialized cargo tankers. Because of its few ships, Sao Tome & Principe relies heavily on foreign-owned ships to carry out the transportation of goods overseas. Consequently, they have little control over when and how long it will take for shipments to be brought to and from the island. This creates a major problem for the country because the people of Sao Tome & Principe are highly dependent on the import of most of their produce and food products, of raw materials for business, and of many other goods needed for daily life. Many Sao Tomeans are also very dependent on the money that comes to them from the exportation of their goods to other countries. For example, Sao Tome & Principe owns only one refrigerated cargo tanker and must therefore rely mostly on foreign tankers to expedite their food and produce shipments. Therefore, the country's lack of domestically-owned ships leads to a lack of control over its imports and exports. In order to combat the volatility of this vital economic sector, it is imperative that Sao Tome & Principe invest in the expansion of its fleet to properly accommodate its shipping needs. This will further smooth out difficulties with import/export businesses in addition to improving access to external markets.

A major problem facing businesses is the current inter-trade arrangement between Sao Tome and Principe. The existing arrangement requires all trade activity for Principe to be routed first through Sao Tome. This increases transshipment costs as well as delays, confusion, and frustration. Investing in a customs office in the city of Santo Antonio will cut out the layer of bureaucracy currently residing. Having their own customs office will allow the inhabitants of Principe to have greater control over customs tariffs, sales tax, etc. By having it under their control, they will have a greater chance of eliminating corruption and help increase government revenues. Cutting out the middleman (Sao Tome) will also alleviate repetition of the business transaction, which will mean greater efficiency, lower costs.

- Land Distribution System

Until recently, the majority of Sao Tome & Principe's land was owned by the government. However, in recent years the country has implemented of a major land reform program with assistance from the World Bank. Its objective is to distribute land from former large, state-owned plantations to small-scale privately owned farms. This program is intended to increase and diversify agricultural production and to promote equity for the Sao Tomeans.

- Airports

The only international airport is located on the island near the capital, Sao Tome. It is served by four airlines. Air Sao Tome & Principe (a subsidiary of TAP Air Portugal) and Air Gabon fly four times a week between Sao Tome and Libreville (Gabon), and Air Sao Tome & Principe makes an inter-island

flight four times a week. Both TAP Air Portugal (from Lisbon) and Angolan Airlines fly in and out of Sao Tome once a week.

In order for an industry such as tourism to survive in such an isolated area, Sao Tome & Principe must be more easily accessible to the outside world. The government has already taken the first step of modernizing its airport and increasing its capacity. Yet, this doesn't serve much purpose if only a very limited few are using the airport. Sao Tome & Principe should seek contracts with more prominent, reputable U.S., European, and Asian airlines to bring more flights in and out of the island. They should also promote the increase of flights per week with Air Portugal and Angolan Airlines. This will make access to the island easier and much more enjoyable, thus increasing the amount of visitors. In addition, Air Sao Tome should have at least one inter-island flight per day, in addition to expanding its operational capabilities in other countries. This will bring more revenues to Sao Tome through the sale of its own airline tickets and by bringing more outsiders into the country, thus promoting the new and upcoming tourism industry.

Economic Diversification

- Agriculture

Agriculture is already the dominant driver of the Sao Tomean economy, with cocoa as the traditional mainstay (accounting for over 85% of its exports). Yet, thus far the country has had the tendency to "put all its eggs into one basket," which has caused severe deterioration to the economy because of cocoa's steep decline in recent years. The country also has a very high food import bill that accounts for nearly one quarter of total merchandise imports, despite the fact that most food needs could be supplied locally. Sao Tome's equatorial climate is optimal for a very diverse approach to agriculture. It has had success with growing such products as coffee, bananas, maize, tomatoes, and many other fruits and vegetables. Nonetheless, due to insufficient funding and large state-owned plantations, agriculture has been mostly devoted to cocoa. However, after a land distribution reform takes place, land will be divided amongst small-scale farmers in promotion of agricultural diversification. In doing so, Sao Tome will be able to depend on its own agricultural products for food while creating more employment opportunities for its inhabitants. Furthermore, it will create economic stability by reducing the country's dependence on a volatile cocoa industry in addition to stabilizing the trade deficit by reducing the food import bill.

- Fishing

Fishing, an industry that is native to Sao Tome which could provide higher returns to the country with improvement. The islands are located amidst prime fishing zones off of the western coast of Africa. Currently there are approximately 2,300 artisanal fishermen who bring in an estimated 3,000 tons of fish annually. Yet, the nearby 160,000 sq. km. Exclusive Economic Zone (EEZ) contains important offshore fishing resources with potential yields of 12,000 tons per year. With oil revenues, Sao Tome can use this money to leverage an agreement allowing it to fish within the EEZ, thus drastically increasing fishing capacity. Money can also be used to support and create more local fisheries, and to increase surveillance and research. Consequently, Sao Tome will be able to reduce its food import bill by supplying its own people with local fish rather than importing from nearby countries. Additionally, it can develop a successful export business with its abundance of tuna and other highly popular varieties of fresh fish. This will also help to balance the trade deficit.

- Tourism

Currently, a maximum of 20 tourists arrive each week to Sao Tome. Reportedly, foreign exchange earnings from tourism in 2002 had nearly quadrupled since 1998, leaping from US\$ 4.1million to US\$ 16.1million. The tourism potential of the islands lies explicitly within its empty beaches, its unusual

and exotic bird species, its extraordinary plantation houses, and its overall immense natural beauty. Sao Tome and Principe are tiny islands, but the land upon which they lie varies from mountainous waterfall-ridden rainforests to coastal flatlands covered with cocoa plantations. With its warm, moist climate Sao Tome is an untapped exotic paradise.

There are a number of easy potential markets that the tourism industry can target. A primary target should be Portugal because of its close ties and similar language. Other wealthy neighboring, oil-bearing nations on the Western African mainland could also serve as successful targets, such as Nigeria. It can serve as an exotic location at an easy distance. Once the country's infrastructure is improved (i.e. reducing its isolation through better airport system, etc.), tourism become a dominant industry within Sao Tome's economy.

Some Caveats to Sustainable Development

By looking at past experiences of other oil-producing African nations, one can see that creating domestic prosperity via oil revenues is a difficult task. If Sao Tome successfully implements such improvements, it will be the minority in comparison to similar countries. One major problem is that there are differing project time frames between the oil industry and government programs. Usually, oil companies are well ahead of schedule with oil exploitation, while the government is slower to commit revenues to any economic and social programs.

Consider the case of Chad, who is currently the fourth largest oil producer in sub-Saharan Africa (Appendix C). The country also expected oil revenues to increase economic development, social programs, pipeline jobs, road-building, as well as monetary compensation to villagers affected by construction. However, the newly created local pipeline jobs turned out to be temporary, and eventually disappeared, as each segment of oil field was completed. In the mean time, social problems, such as prostitution, proliferated along the pipeline routes creating an upsurge in AIDS cases. These are all problems that Sao Tome & Principe could face, and thus must learn the mistakes of previous experiences by other countries.

Joint Development Zone (JDZ) Agreement

Currently de Menezes is trying to renegotiate the terms of the JDZ Agreement settled upon by his predecessor. This has been met with opposition mainly by the country's National Assembly. It believes that the move is invalid since the agreement has already been decided and consented upon by the two parties involved. It believes that the president is overstepping his limitations on power by contesting it.

De Menezes' concerns are understandable. By giving Nigeria the majority claim in its oil production and revenues, it is putting itself in a position to be taken advantage of. Nigeria is a large, powerful, and corrupt country who would undoubtedly capitalize on Sao Tome's weakness as a nation and its inexperience in oil production. For this reason, de Menezes' concerns and actions are plausible, for he is only looking for the best interest of his country. However, if he is to retract on the agreement, this will severely hamper Sao Tome's credibility in the future with other countries. Therefore, he should seek other forms of protection from Nigeria through the creation of close military ties with other powerful nations. Currently, Sao Tome is negotiating the possibility of employing a U.S. Military Base on its island. This will grant further protection to the country from any possible exploitation of power by Nigeria.

Government Transparency

Sao Tome & Principe is in the early stages of creating a democratic government. Many of the nation's industries are still nationalized, which keeps much of the government's actions undisclosed to the public. By keeping power within the hands of the ruling minority, this leaves Sao Tome susceptible to continuous corruption by its leading officials. This hampers economic growth by dissuading foreign companies and nations from investing in its resources and operations. Therefore, de Menezes should encourage the privatization of its industries and various economic sectors in his fight against corruption. This will promote FDI and in turn diminish the country's economic stagnation and complacency.

Exxon Mobil Perspective

Company Profile

The company currently has global interests and commitments in nearly 800 deepwater blocks totaling over 95 million gross acres. Specifically within the region of Sub-Sahara Africa, the company holds interests in 19 blocks totaling nearly 18 million gross acres (Appendix B, West Africa Net Acreage). It is also the only major international oil company that operates in or has interest in fields using all of the principal deepwater production systems. This implies that Exxon might be able to enter and explore other markets previously inaccessible due to technology limitations. Additional exploration, appraisal and rapid commercialization of discoveries are clear priorities in the coming years. However, it is important to note that oil exploration costs are significant as deepwater wells costs US\$20-50 million, thus making them major capital investments.

Net Present Value of Sao Tome Oil Reserves

Discount Rate and Adjustments

The discount rate for the Project is computed using the Weighted Average Cost of Capital method. This model takes into account the firm's cost of capital, as represented by its debt outstanding and common equity. This model also takes into account the weights of these financing options that the firm has chosen. Exxon Mobil's cost of equity was computed using the Capital Asset Pricing Model. Using the company's Beta, the market risk premium, and the 30-year Treasury zero-coupon bond yield, we arrived at a cost of equity of 6.65%. Since Exxon Mobil is a AAA/Aaa debt-rated company by both Standard & Poor's and Moody's, we used the 30-year Treasury yield, plus the 30-year default spread for a AAA-rated company to arrive at a cost of debt of 5.86%. Exxon Mobil is not overleveraged as over 90% of its assets are financed by equity. These figures were weighted and the after-tax benefit of debt was accounted for to arrive at a Project WACC of 6.49%.

Since discount rates are used to reflect the wide variety of risks inherent in a project, the WACC used to evaluate this oil project was adjusted to best reflect project-specific risk. The initial company WACC is the "base" discount rate. This base rate was then adjusted to reflect project specific risks, which becomes the Property Specific Discount Factor. Since Exxon is currently the holder of offshore leases in Sao Tome and such offshore properties often involve additional production and economic risks in comparison to onshore properties, we added 2% to the base rate, arriving at an adjusted WACC of 8.49%

Explanation of WACC

Exxon Mobil's Weighted Average Cost of Capital reflects its position as one of the world's largest, fully integrated international petroleum firms with a massive and well diversified hydrocarbon reserve base that offers numerous development opportunities. In addition, it also reflects Exxon's significant global market position in chemicals and well managed financial position.

Exxon Mobil's functional and geographic diversity helps mitigate the impact of volatile commodity prices, cyclical refining, and chemical results on its earnings and cash flow. This allows the company to maintain a high level of capital investment throughout the commodity price cycle. Exxon Mobil's considerable financial flexibility also enables it to acquire substantial reserves in regions with high political risk without impairing its credit quality. These strengths more than offset the following risks:

volatile commodity prices, significant reserve replacement challenge, and refining & marketing segment issues, which include competition and environmental regulation. All these factors contribute to the firm's low Beta and its superb long-term rating of AAA/Aaa.

Net Present Value

The NPV of the Project was arrived at using forecasted cash flows, which were discounted back to 2003 using the adjusted WACC. Cash flows were based on the Economist Intelligence Unit's forecasted daily oil production volume in the JDZ blocks allotted to Exxon Mobil. These volume forecasts were then multiplied by 365 days of production. This total amount of oil pumped in a year was then multiplied by the Historical Average Cost of oil per barrel, which presented the Cash Revenue in that particular year. The cash flows for the duration of the project, 40 years, were then discounted back to 2003.

The next step was to take into account the costs associated with the Project. Comparable oil pumping projects in the region by Exxon Mobil were used to value the investment costs of this Project. The Sao Tomean reserves were estimated at 4 billion barrels and the average cost per 1 billion barrels of oil pumped is US\$3.4 billion in the region. We assumed that Exxon Mobil will make continuous investments in the Project at even-time intervals, resulting in 4 investments of US\$3.4 billion every 10 years. Using the adjusted WACC, these investments were discounted back to 2003 to arrive at the Present Value of the investment.

The NPV of the project was split according to the terms defined in the agreement between Sao Tome and Exxon Mobil. Exxon Mobil receives 40% of the earnings and faces all costs. Using these assumptions, we arrived at the Net Present Value of the Project for Exxon Mobil of just over US\$1 billion (specifically, US\$1,053,671,807.71).

By investing in a developing country such as Sao Tome, Exxon should be aware of the additional investment costs that it will need to assume. Since the domestic government's capacity to oversee the project implementation is limited, the government will pass as much investment responsibility to the private sector as possible. This phenomenon is illustrated in Exxon having concession rights as opposed to a lease arrangement with Sao Tome. Concession rights are not only a transfer of ownership from domestic to foreign residence, but also a mechanism that makes it possible for foreign investors to exercise management and control over host country firms – a corporate governance mechanism. On the other hand, a lease arrangement would imply that the private sector was not required to commit any investment funds. Also, many developing and emerging countries will cut or reduce their corporate tax rates in order to attempt to attract FDI from other locations.

While oil demand in the US and Europe are expected to increase in coming years, demand growth in Asia will overwhelm the increase in other parts of the world. Net imports into the US and Europe are estimated to be about 3 million barrels per day over the next few decades. While those increases are significant, they are dwarfed by an expected increase in Asia's net imports of about 15 million barrels per day. Currently Asia gets a substantial amount of its oil from the Middle East. As such, countries consuming high levels of oil are looking for alternative sources outside the turbulent politics of the Middle East. Sao Tome presents a solution to this current problem.

Who's Hot? Who's Not?

A-List (Hot)	B-List (Cool)	C-List (Cold)
Northern Caspian	Kuwait	Indonesia
Deepwater US	Australia	Sudan
Trinidad	Algeria	India
Equatorial Guinea	Saudi Arabia	Falklands
Angola	Iran	Rest of US
Sao Tome & Principe	Deepwater Malaysia	Alaska
Mauritania	Russia	Myanmar
	Egypt	Argentina
	Nigeria	Venezuela
	Morocco	Brazil
	China	
	Ghana	

Source: 2003 LexisNexis.

Compared to its neighboring African countries, Sao Tome's oil is offshore and insulated from domestic political or social turmoil. This creates a more favorable environment for foreign direct investment. Unlike the Middle East, political discord and dispute in African oil states are unlikely to carry regional or ideological tones that would result in a joint embargo by suppliers at once. Eighty percent of the Sao Tomean population is Catholic, as opposed to Muslim, and there is no anti-American sentiment. In addition, the US and Sao Tomean governments have discussed plans for the future establishment of a U.S military presence on Sao Tome, similar to US regional command in South Korea. According to the Freedom House Country Ratings, political rights ratings for the country are identical to United States. However, for the category of civil liberties, the ratings indicate that Sao Tome is only "partly free" (AppendixD: Freedom House Country Ratings). Despite its weakness in civil liberties, Sao Tome's country ratings are better than most emerging market countries as well as other oil producing countries. The greatest risk that the company is faced with has to do with the border and contract disputes between Sao Tome and Nigeria. The issue has been an item of contention between the two countries for the past three years and the disputes have resulted in delays for the project start date.

Another benefit to investing in Sao Tome is that African oil tends to be of high quality since it is low in sulfur, giving it a growing market share for refining centers. Sao Tome's oil reserves are also optimally located within the West African coast and Atlantic Ocean. From this strategic location, it is easier and cheaper to transport oil to the US as opposed to the Gulf or Caspian Sea. In addition, since Sao Tome would be a non-OPEC country, Exxon Mobil would not be subject to quota constraints set by OPEC. OPEC is an international Organization comprised of 11 developing countries: Algeria, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, the United Arab Emirates and Venezuela. These countries heavily rely on oil revenues as their main source of income. Their aim is to bring stability and harmony to the oil market by adjusting their output to help ensure a balance between supply and demand. Collectively, these 11 countries supply about 40% of the world's oil output and possess more than $\frac{3}{4}$ of the world's total proven crude oil reserves.

Historically, oil extraction has used 100% imported technology that was operated by 100% expatriate workers and located in an offshore platform isolated from the remainder of the country. Should this pattern for oil development be the case in Sao Tome, there will be no significant effects on resource

demand for the local economy because Exxon Mobil will use almost no domestic capital, labor, or even consumption items from the local work force. Sao Tome's economic sustainability is not Exxon's greatest concern. However, Exxon will bring in assistance from other sources, such as the World Bank, which will promote economic development within the country.

JDZ Agreement

Since Sao Tome is located so close to Nigeria, they face the potential threat of being overtaken by Nigeria. Furthermore, Nigeria is for a pushing mutual defense treaty, which would allow several hundred Nigerian troops to enter Sao Tome. With the Nigerian military presence, it is highly probable that the army would try to overtake Sao Tome & Principe. Thus, Exxon Mobil's oil interest would be rendered invalid or transferred to Nigeria.

Corruption and Transparency

Whereas transparency advocates demand, oil companies assume responsibility for their contribution to corruption by publicly disclosing details of the payments to foreign governments. However, Exxon believes that it is impossible to be competitive when seeking projects in Africa without partaking on such strategies. Exxon recognizes that they have a responsibility to the local population, but when it comes to government policies, it is not their role as a foreign firm to suggest, or try to influence, economic policy. In other words, Exxon has a 'When in Rome, Do as the Romans' attitude.

Alternative Energy Sources: Determined to cut its dependence on oil imports, President Bush plans to spend US\$1.2 billion over five years to develop "Freedomcar" fuel cell vehicles(FCR), in addition to the infrastructure to make, store, and distribute the "FreedomFUEL" hydrogen to power them. Already in Europe, Hydrogen is expected to take a 3% share of the European auto fuel market by 2010. This year, the number of hydrogen filling stations worldwide will nearly double to 65. Germany alone is home to 13 hydrogen stations. Japan has 11. The US has just 14, with 10 in California. German carmaker BMW expects the number of filling stations in Europe to increase from 30 to 2,000 within the next five years, increasing to over 12,000 stations by 2016.

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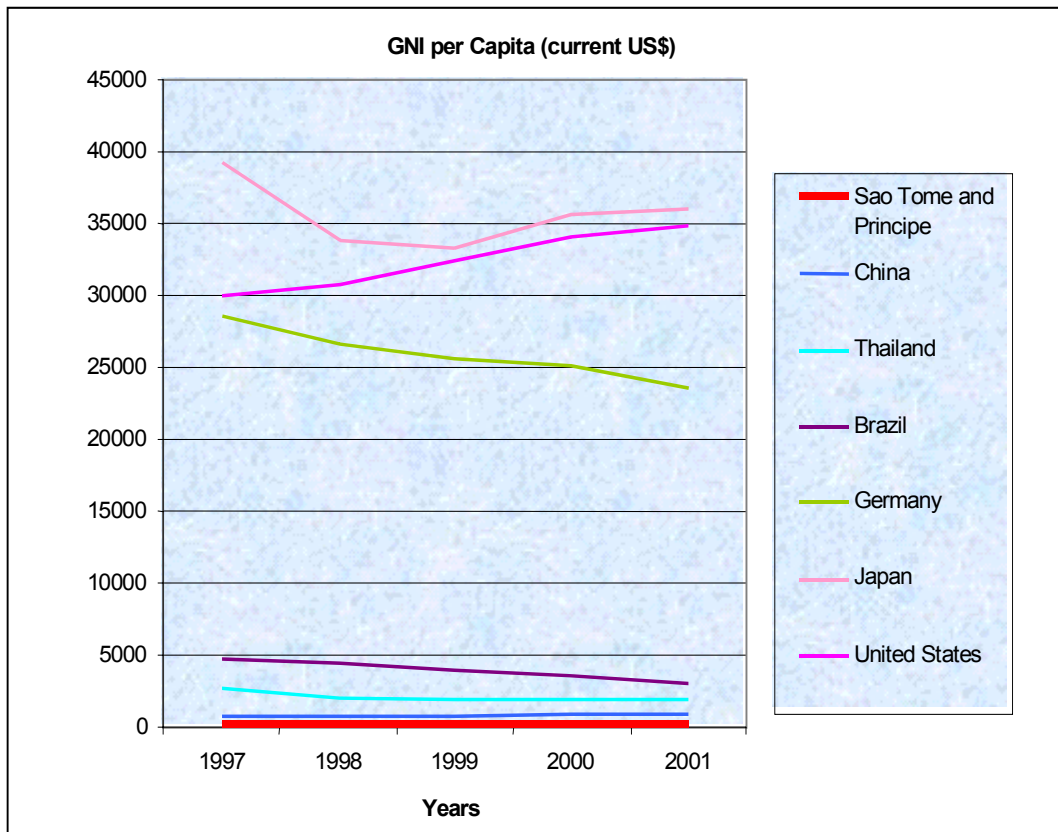
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V. Appendices

Appendix A

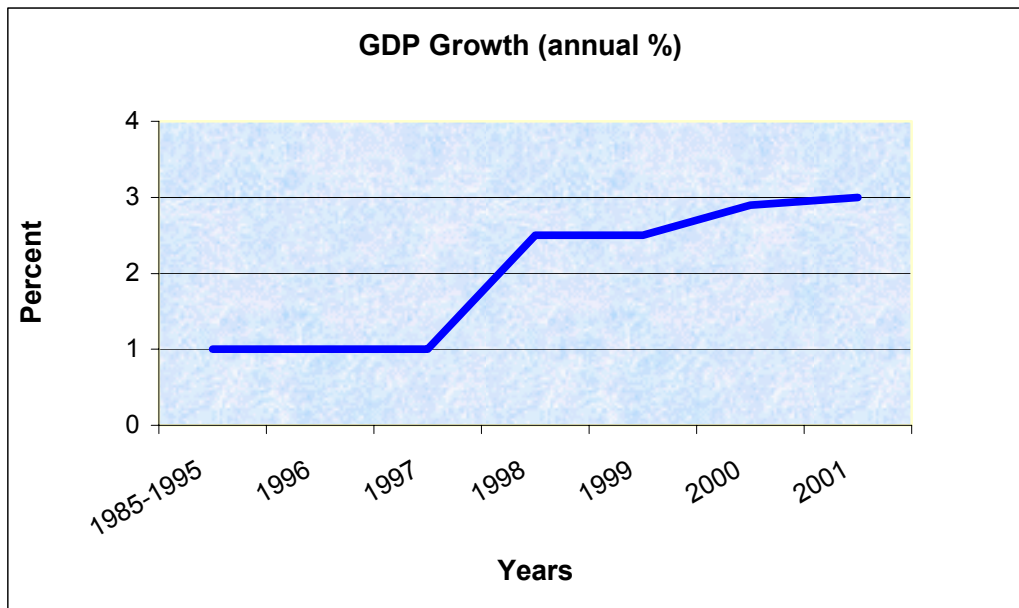
Graph 1

Source: World Bank Group



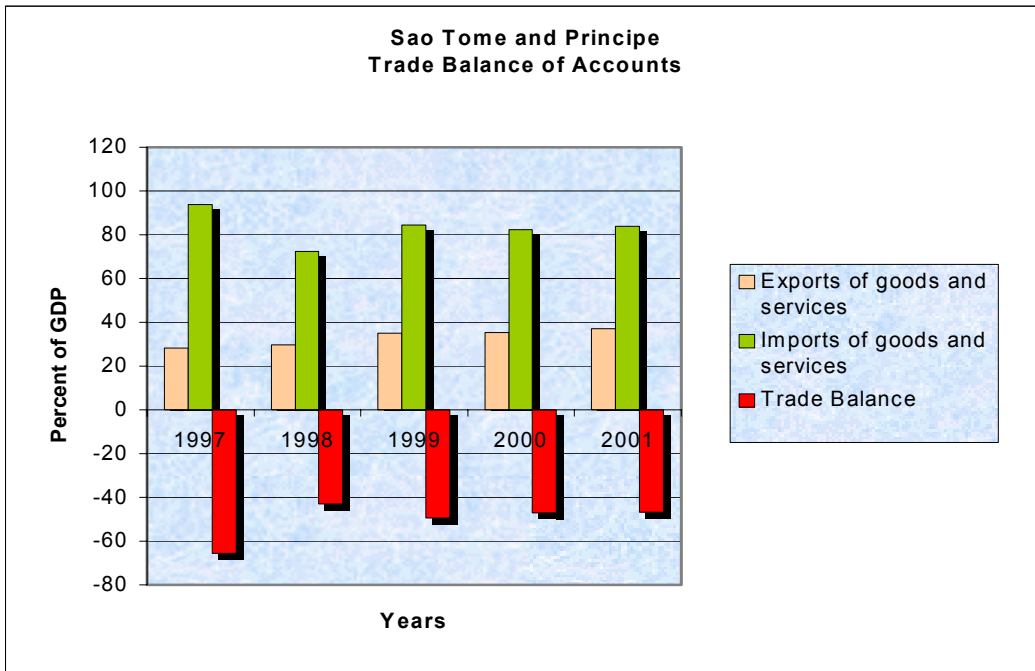
Graph 2

Source: The Economist Intelligence Unit



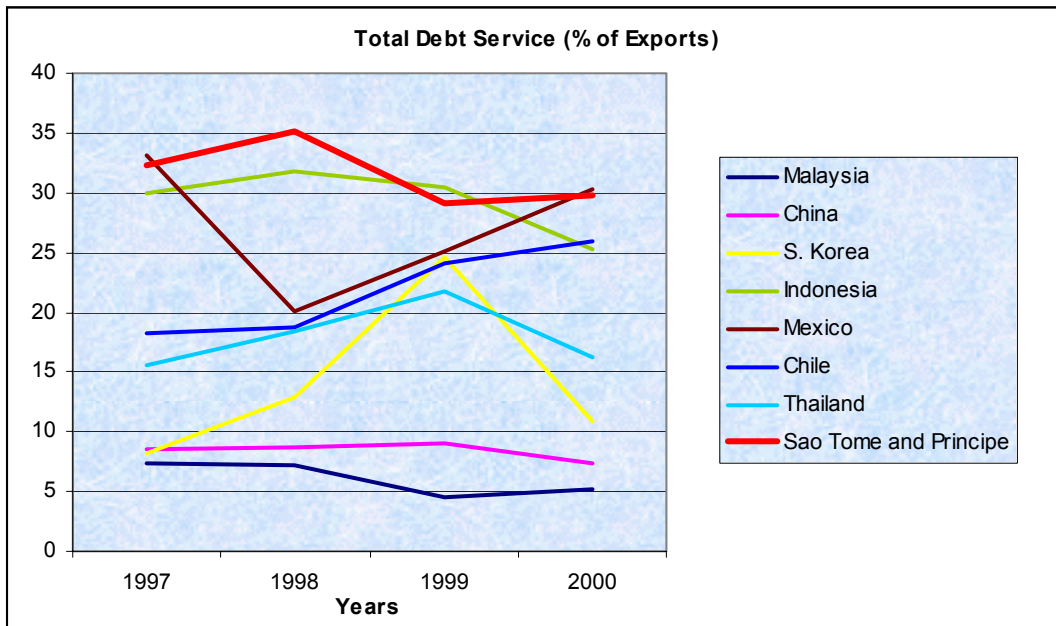
Graph 3

Source: World Bank Group



Graph 4

Source: World Bank Group



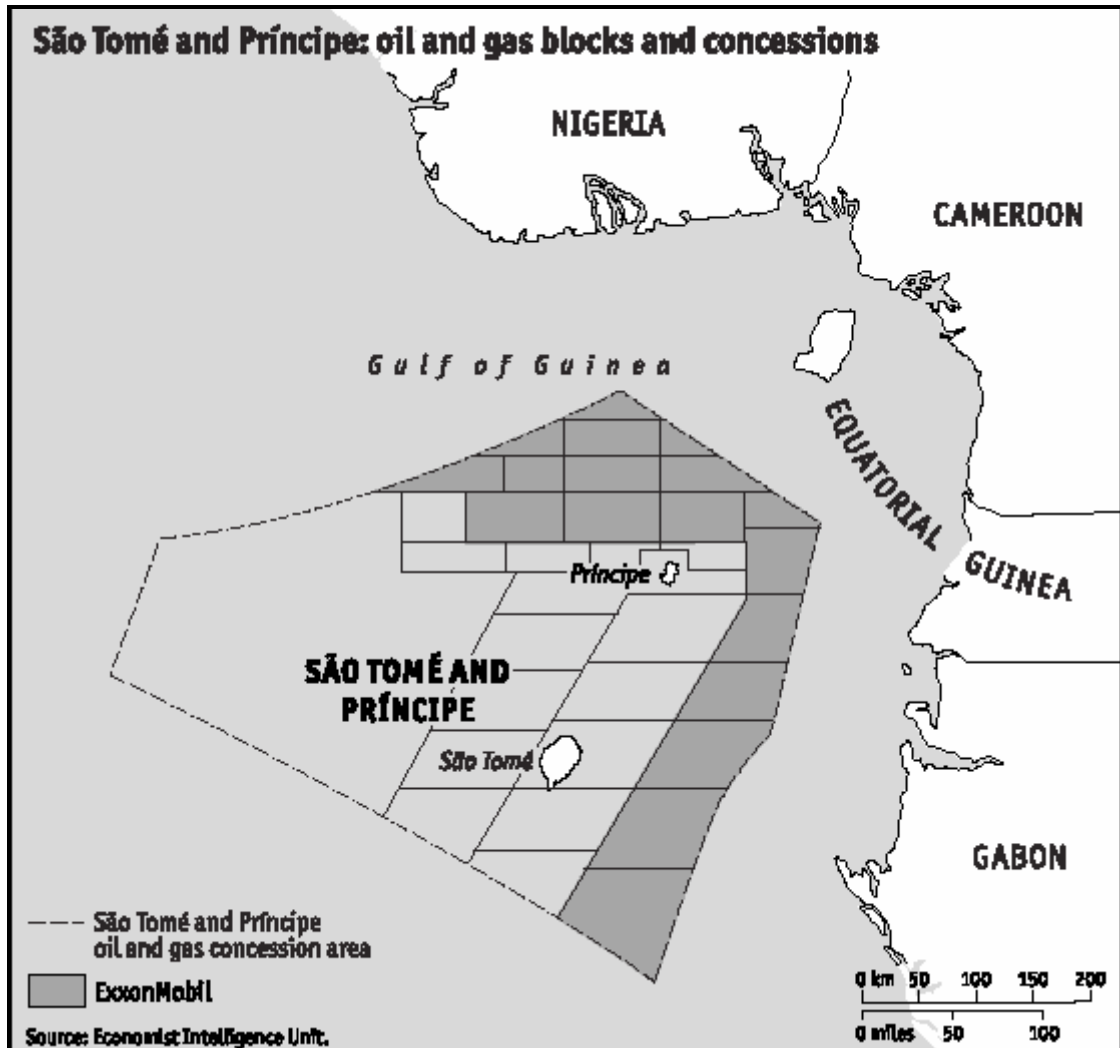
Appendix B

Exxon Mobil Current Project Activities

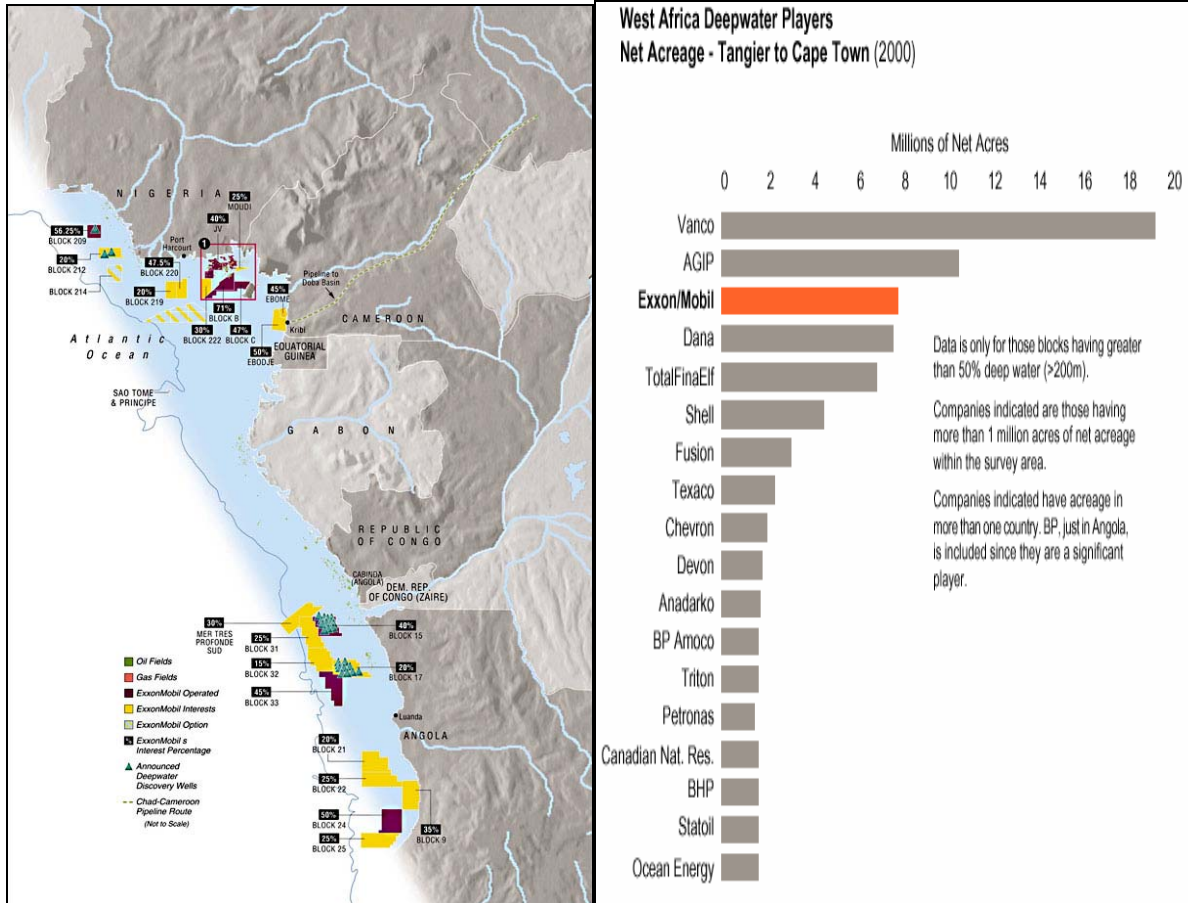
RECENT PROJECT START-UPS (Actual & Projected)	Target Peak Production (Gross)		ExxonMobil Working Interest
	Liquids	Gas	
	(kBD)	(MCFD)	
2000			
Canada – Syncrude Aurora Phase 1	105	–	25
Equatorial Guinea – Jade	60	–	75
Germany – Nordsee A6/B4	5	150	20
Kazakhstan – Tengiz Program 12 + Train 5	75	175	25
Malaysia – Irong Barat Redevelopment	10	–	78
Norway – Aasgard B/C	105	940	7
Norway – Oseberg South	95	–	4
Norway – Sygna	35	–	18
Qatar – RasGas Train 2	10	525	25
United Kingdom – Shearwater	65	370	45
United Kingdom – Skiff	–	90	50
United Kingdom – Triton	90	80	23
United States – Hoover-Diana	65	265	67
2001 (Projected)			
Angola – Girassol	225	–	20
Canada – Terra Nova	125	–	22
Kazakhstan – Tengiz LPG/Gas	25	35	25
Norway – Greater Balder Area (Ringhorne)	60	–	100
Norway – Snorre B	110	–	11
United Kingdom – Brigantine	–	120	50
United Kingdom – Elgin/Franklin	180	485	4
United States – Mica	10	130	50
United States – Nile	3	65	50
2002-2003 (Projected)			
Canada – Cold Lake 11-13	45	–	100
Canada – Sable Offshore Energy Tier 2	15	365	60
Indonesia – Cepu	95	–	90
Malaysia – Angsi	60	260	50
Malaysia – Larut A	35	25	50
Netherlands – Groningen Clusters 2, 3, 4	–	575	30

Nigeria – Etim Redevelopment	25	–	40
Nigeria – Usari Phase 2/Satellites	75	–	40
Norway – Sigyn	30	70	40
Norway – Grane	200	–	26
Norway – Fram West	60	70	25
Norway – Mikkel	30	175	34
United Kingdom – Cleaver Bank Phase 1 & 2	–	130	48
United Kingdom – Skene	20	155	38
United States – Borealis	30	–	37
United States – Madison/Marshall	15	10	100
2004+ (Projected)			
Angola – Kizomba A	250	–	40
Angola – Kizomba B	250	–	40
Angola – Mondo, Saxi, Bartuque	200	–	40
Angola – Xikomba, Marimba	80	–	40
Angola – Dalia	200	–	20
Angola – Rosa Area	150	–	20
Australia – Kipper/Pilchard	55	85	37
Azerbaijan – Megastructure (full field)	1000	–	8
Canada – Aurora Phases 2 & 3	185	–	25
Canada – Cold Lake 14-16	40	–	100
Canada – Mackenzie Delta	15	1000	60
Chad – Doba	225	–	40
Italy – Tempa Rossa	50	10	25
Kazakhstan – Kashagan	1000	1500	14
Kazakhstan – Tengiz Future Expansions	480	190	25
Malaysia – Guntong Hub	5	350	50
Netherlands – Groningen Clusters 5-10	–	1150	30
Nigeria – Bonga	200	150	20
Nigeria – East Area Additional Recovery	80	–	40
Nigeria – East Area NGL	40	–	40
Nigeria – Erha	210	–	56
Nigeria – Yoho	150	–	40
Norway – Haltenbanken-Kristin	105	475	12
Norway – Sleipner West Compression	45	920	32
Qatar – Enhanced Gas Utilization	180	1750	100
Qatar – RasGas Trains 3 & 4	60	1600	30
Russia – Sakhalin 1 (full field)	250	1000	30
United Kingdom – Goldeneye	35	260	40
United States – Alaska Gas Pipeline	–	4000	36
United States – Crazy Horse Phase 1	250	200	25
Yemen – LNG	–	900	38

Exxon Mobil Off-Shore Blocks



West Africa Net Acreage



Appendix C

Effects of Oil Production on Neighboring Countries

The production of oil in many countries, while it may bring a huge influx of much needed capital, rarely actually makes a dent in the lives of the people living in the region. If anything, it severely disrupts the social, economic and political aspects in running the country. Corruption is abundant in the government and allows only the rich and those in power to benefit from oil revenues. The majority of the people are forced to deal with the environmental after-effects, possible relocation from their homes, increase frequency in crimes and prostitution leading to an increased number of health related problems, etc. Sao Tome & Principe must learn from the mistakes and experiences of its neighbors to make sure they do not fall into the same pitfalls.

Federal Republic of Nigeria

Between 1970 and 2000, according to World Bank estimates, Nigeria earned about US \$320 billion from crude oil exports. The Niger Delta, however, with over seven million inhabitants, received no real benefits in terms of basic social amenities, infrastructure and general welfare. In the past decade, neglect suffered by the region also fueled negative feelings among impoverished locals. Violence swirled through the region as angry youths disrupted oil operations, kidnapped expatriate employees of oil multinationals for ransom or fought each other for the few benefits that came from oil companies.

Republic of Chad & Republic of Cameroon

The Chad-Cameroon pipeline, operated by Exxon-Mobil with additional investments from Chevron Texaco and Petronas, is being built amid disputes between oil companies and local people in nearby Nigeria. The project will yield an estimated \$500 million in revenues for Cameroon and almost \$2 billion for Chad over a 25-year oil production period. The pipeline project will bring in hard currency royalty payments to help service the foreign debt. The project plans to create about 600 jobs in Cameroon for the duration of the pipeline construction. This is not much for a large investment, including several hundred million dollars from the World Bank Group, and hardly a contribution to sustainable development given the considerable social and ecological risks of the project. In western Cameroon protests grow about the pipeline that will bring oil from Chad to the coast. Local people argue that the project has failed to bring the social benefits expected. The involvement of the bank, in the face of misgivings expressed by independent inspectors, has raised expectations on issues such as compensation for environmental damage and terms of employment. The bank argues the pipeline is precisely the sort of development where its approach can help, bringing a framework of environmental, social and anti-corruption safeguards to bear on a highly lucrative enterprise.

Republic of Equatorial Guinea

Thanks to oil, Equatorial Guinea boasts one of the highest per capita gross domestic products in Africa, although few of the benefits have yet to be felt in important sectors such as health and social welfare. The problem is that few of its people appear to be better off. One reason is that contracts - as is typical in these cases - have been structured so that oil companies take an early share of the profits to help them recoup their investment. The government's share of the oil revenues is increasing. The IMF estimates are that the government will take 24.3% of gross oil revenues this year, compared with 16.4% in 1998. While its share will rise to 30.7% in 2003, it will still fall short of the 45% to 50% enjoyed by Angola and Nigeria. There, the state has an average 57% stake in large oil licenses.

Republic of Angola

There is growing concern that most of the money is not being spent on economic development, and that the majority of Angolans are not benefiting from the country's oil wealth. An internal report by the International Monetary Fund (IMF) found that nearly \$1bn disappeared from Angolan Government finances last year. Larger companies were not showing signs of working towards increased transparency. Oil companies are also nervous of criticizing the government since they are constantly in negotiations over the right to exploit newly discovered oil fields.

Appendix D (available in separate document)

Appendix E (NPV Analysis available in separate document)

Exxon Mobil Weighted Average Cost of Capital

Company Relevants:

Equity:

Shares Outstanding (4/8/03):	\$6,690.00
Price per Share (4/8/03):	\$34.94
Market Capitalization (millions \$):	\$233,748.60

Beta: 0.34

Debt (12/31/02):

Notes and loans payable	\$4,093.00
Long-term debt	\$6,655.00
Deferred credits and other long-term obligations	\$2,511.00
Total Debt (millions \$):	\$13,259.00

Income before income taxes	\$17,510.00
Income taxes	\$6,499.00
Tax Rate:	37.12%

Standard & Poor's Credit Rating: AAA

Computations:

Historical Average Annual Market Return: 10%

Treasury 30-year Yield (4/7/03): 4.92%

30-year Corporate AAA Default Premium: 0.94%

Exxon Mobil 30-year Before Tax Cost of Debt: 5.86%

Capital Asset Pricing Model: 6.65%

WACC: **6.49%**

Offshore Lease Risk Adjustment: 2%

Discount Rate for Sao Tome Project: 8.49%

OPEC Oil Prices

Year	\$ Per Barrel
1981	\$34.15
1982	\$31.72
1983	\$28.78
1984	\$28.06
1985	\$27.54
1986	\$13.73
1987	\$17.23
1988	\$13.40
1989	\$16.21
1990	\$20.82
1991	\$17.43
1992	\$17.94
1993	\$15.68
1994	\$15.39
1995	\$16.73
1996	\$20.29
1997	\$18.71
1998	\$12.28
1999	\$17.47
2000	\$27.60
Historical Average:	\$20.56

Appendix F (available on Exxon Mobil website:
<http://www.exxonmobil.com/Corporate/InvestorInfo/SECFilings.asp>)

Appendix G (available only as hard copy)

Appendix H

Exxon Mobil Financial Highlights

- The 1999 merger between Exxon and Mobil significantly increased earnings in recent years by reducing redundancies and increasing efficiency. Exxon estimates that it added almost 6 billion to its bottom line in 2001, and expects that merger related savings will continue to increase as it identifies and exploits additional efficiencies.
- The company has been profitable for decades and has earned at least \$1 per share in each of the past 10 years.
- The firm is the most profitable and financially efficient of the major oil firms. It's fanatical focus on generating excess returns on capital employed has paid off with strong profitability.
- Even though the company operates in an extremely capital intensive industry, less than 8% of its assets (US\$150 billion) is funded by debt. However, if you back out cash and on-hand inventory, the company is relatively debt free. This should allow the firm to better withstand economic downturns than most in the industry.
- Revenue and profits are highly cyclical because of the company's dependence on oil prices. In 2000, there was a 25% sales growth followed by a 9% decline in 2001.
- Oil is a volatile commodity with unpredictable prices and an oversupply can greatly drain profits. If OPEC lost its hold and oil prices fell, industry wide returns would suffer
- Although the company does not pay as high a dividend as others companies, its payout ratio is consistent with its competitors. In addition, the dividend-tax plan would not benefit the shareholders of Exxon Mobil's foreign based competitors, making the firm a relatively attractive investment.

(2002 Annual Financial Statements)

Appendix I

EXXON-MOBIL: CORPORATE HISTORY

Late 1800's:

- ❖ In 1863, Founder John D. Rockefeller, a commodity trader, started his first oil refinery in Cleveland. Realizing that the price of oil at the well would shrink with each new strike, Rockefeller chose to monopolize oil refining and transportation.
- ❖ In 1870 formed Standard Oil
- ❖ In 1882 created the Standard Oil Trust, allowed him to set up new, ostensibly independent, companies, including the Standard Oil Company of New Jersey (Jersey Standard); Rochester, New York-based Vacuum Oil; and Standard Oil of New York (nicknamed Socony). Initially capitalized at \$70 million, the Standard Oil Trust controlled 90% of the petroleum industry.

Early-Mid1900's:

- ❖ In 1911, Supreme Court broke up the trust into 34 companies, the largest of which was Jersey Standard.
- ❖ In 1928 Jersey Standard joined in the Red Line Agreement, which reserved most Middle East oil for a few companies.
- ❖ The 1948 purchase of a 30% stake in Arabian American Oil Company, combined with a 7% share of Iranian production bought in 1954, made Jersey Standard the world's #1 oil company at that time. Vacuum Oil and Socony reunited in 1931 as Socony-Vacuum, and the company adopted the Flying Red Horse (Pegasus -- representing speed and power) as a trademark.

The 70's - 80s:

- ❖ The fast-growing, diversifying company changed its name to Socony Mobil Oil in 1955 and became Mobil in 1976. Other US companies, still using the Standard Oil name, objected to Jersey Standard's marketing in their territories as Esso (derived from the initials for Standard Oil). To end the confusion, in 1972 Jersey Standard became Exxon, a name change that cost \$100 million.
- ❖ Nationalization of oil assets by producing countries reduced Exxon's access to oil during the 1970s. Though it increased exploration that decade and the next, Exxon's reserves shrank.
- ❖ In 1989, Oil tanker *Exxon Valdez* spilled some 11 million gallons of oil into Alaska's Prince William Sound. Exxon spent billions on the cleanup

The 90's to 2001:

- ❖ 1994 a federal jury in Alaska ordered the company to pay \$5.3 billion in punitive damages to fishermen and others affected by the spill. (Exxon appealed, and in 2001 the jury award was overturned.)
- ❖ Exxon merged its worldwide oil and fuel additives business with that of Royal Dutch/Shell in 1996. The next year, under FTC pressure, Exxon agreed to run ads refuting claims that its premium gas enabled car engines to run more efficiently.
- ❖ In 1998, CEO Lee Raymond upset environmentalists by publicly questioning the global warming theory.
- ❖ Acquired Mobil for \$81 billion in 1999. To get the deal done, Exxon Mobil had to divest \$4 billion in assets. It agreed to end its European gasoline and lubricants joint venture with BP and to sell more than 2,400 gas stations in the US.
- ❖ In 2000 Exxon Mobil sold 1,740 East Coast gas stations to Tosco for \$860 million. It sold a California refinery and 340 gas stations to Valero Energy for about \$1 billion.
- ❖ In 2001, more than a decade after the *Exxon Valdez* wreaked environmental havoc off the shores of Alaska
- ❖ In 2001, joins the California Fuel Cell Partnership, a group studying possible alternatives to, and supplements for, gasoline in fuel-burning engines.
- ❖ In 2001, announced that it was proceeding with a \$12 billion project (with Japanese, Indian and Russian partners) to develop oil fields in the Russian Far East.

2002:

- ❖ Sold its 50% stake in a Colombian coal mine as part of its strategy to divest coal assets in order to focus on its core businesses.
- ❖ Sold its Chilean copper mining subsidiary (Disputada de Las Condes) to mineral giant Anglo American for \$1.3 billion.
- ❖ Exxon Mobil and Guangzhou Petrochemical (a subsidiary of China Petroleum & Chemical Corp., or Sinopec Corp., in which Exxon Mobil has a 19% stake), began negotiations on a \$3.24 billion deal to jointly expand capacity at Guangzhou's refinery.

VI. Press Releases

(available only as hard copy)