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BULLETIN

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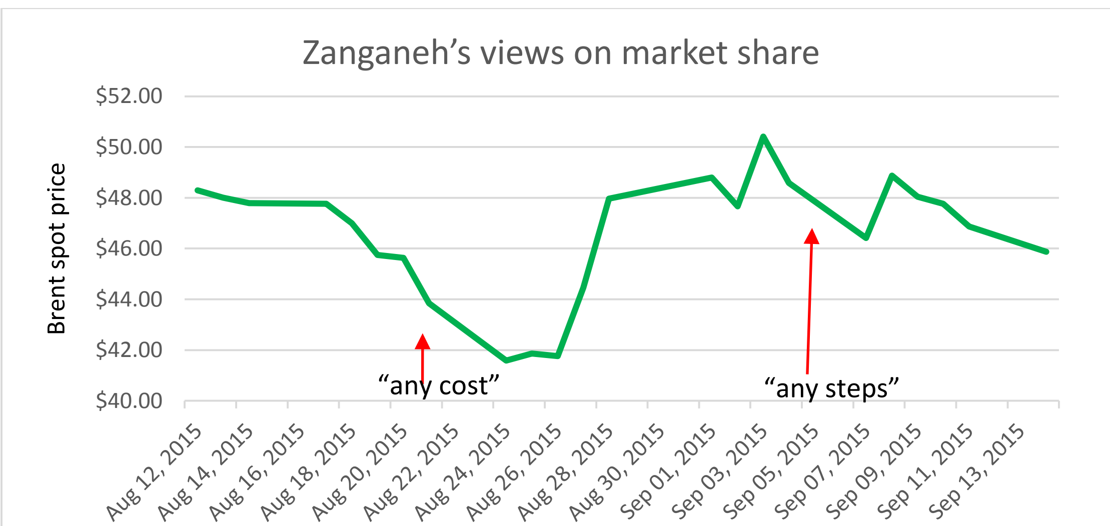
IRAN HONES ITS OIL STRATEGY

How will Iran's NIOC compete against other producers to regain market share if the nuclear deal is implemented smoothly by Q2 2016? Iran has stopped threatening an all-out price war during the past few weeks, but ultimately its policies may be tested when it comes down to resuming sales to individual refiners.

Iranian Oil Minister Bijan Zanganeh, as well as his subordinates, have become more cautious since threatening to regain market share "at any cost." At his first OPEC Ministerial meeting since returning as Iran's oil minister, Zanganeh vowed that Iran would double its exports "even if prices go down to $20 per barrel." That was in December 2013, when Brent was trading at $110. Late last month, however, when it looked like Brent might slip below $40, Zanganeh began to moderate his tone.



Erratic Statements from Zanganeh

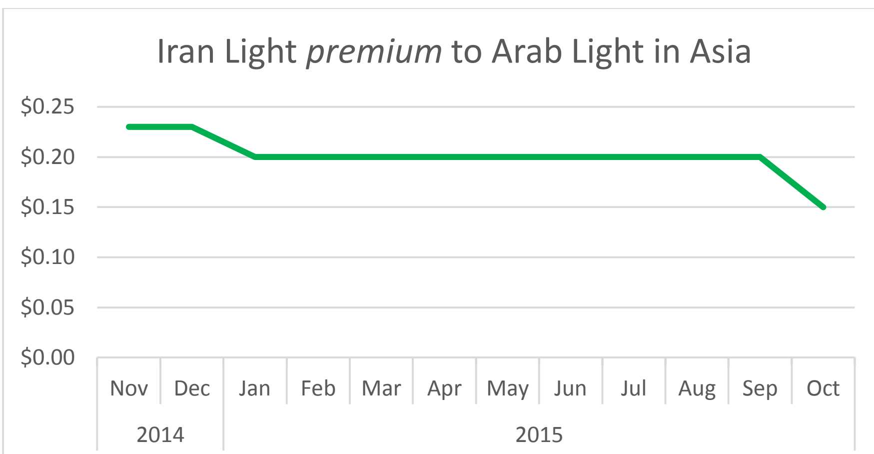
As recently as August 23, Zanganeh vowed to raise oil production "at any cost" to regain share following sanctions removal. He vowed that Iran would raise production by 1 million b/d by March 2016. He made those comments despite a sharp $6 price drop in mid-August. When prices started another slide early this month, he took another tack, saying on

September 8 that Iran "supports and welcomes any steps to help the oil market recover and escape the current conditions." He was reacting to a Venezuelan proposal for OPEC and non-OPEC coordination, not necessarily volunteering restraint on Iran's part. Zanganeh has consistently supported OPEC cuts as long as Iran could increase production to 4 million b/d.

October OSPs

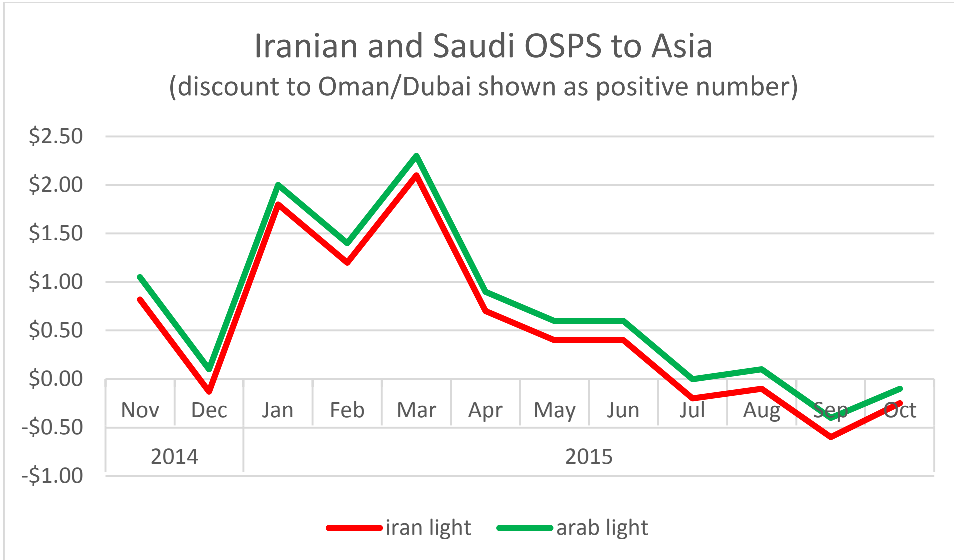
On September 9, NIOC announced its official selling prices for October, dropping the premium for Iranian Light against Arab Light by 5 cents per barrel--the first time since January that NIOC had not tracked its OSPs completely in line with Saudi Aramco's.

On September 11, Goldman Sachs predicted that Brent could sink as low as $20 and revised its overall forecast for 2016 prices to $49.50 from $62 per barrel due in part to Iran's presumed re-entry into the market.



Downplaying OSP Adjustment

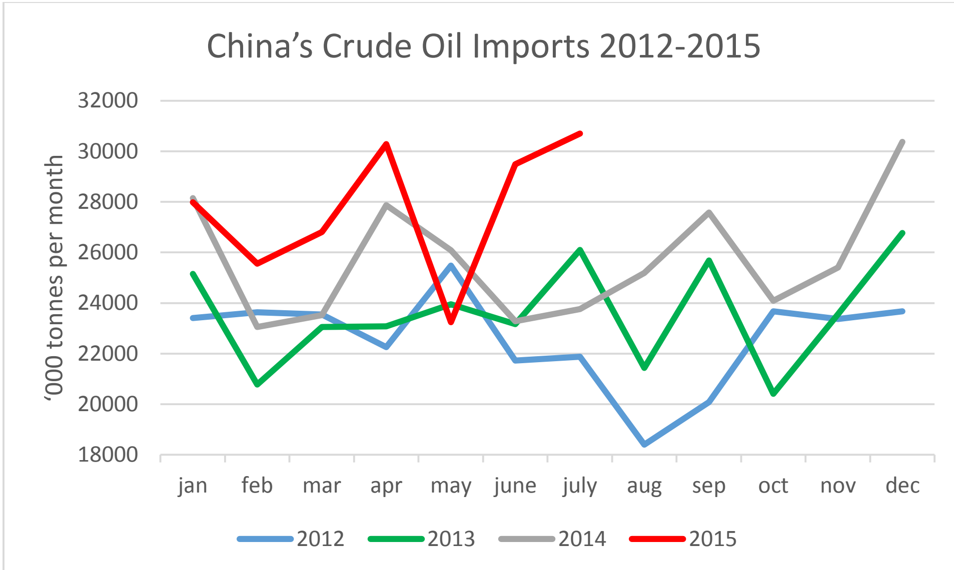
On September 14, NIOC's international director Mohsen Ghamsari told the press that the 5-cent cut was not extraordinary. "When Saudi Arabia decreases its oil price it is natural that Iran cuts its oil price, considering the quality difference. Otherwise it will lose market share," Ghamsari said. "Iran's light crude oil price is normally 10-20 cents higher than Saudi's light oil price and this issue has been considered."



No More Discounts
On September 16, one of Ghamsari's advisors, Ali A. Arshi, told oil company officials in Seoul that Iran wanted to use the lure of upstream business, rather than further discounts, in order to secure term buyers for its crude once sanctions were lifted. It "is not our policy to make [more] discounts," he told *Reuters* in Seoul. He repeated exaggerated claims that Iran had plans for $185 billion in oil and gas investment by 2020.

China as the "Swing Buyer"
Nothing definitive can be gleaned from these Iranian comments other than that they show a more realistic view of the market realities that will face the main Gulf producers once sanctions are lifted.

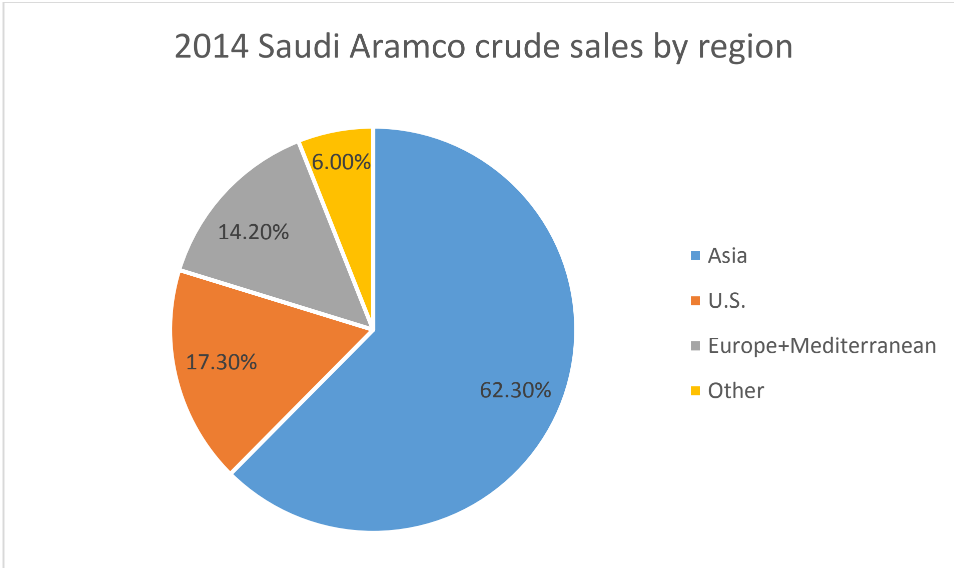
If Iran signals that it will seek to regain market share at any cost, the main buyer of Gulf crudes, China's Unipec, is likely to do all it can to encourage a price war between Iran, Iraq and the GCC producers. Unipec is in a position to play off these producers against each other and it will have no qualms about doing so. It has been the key player in creating 20% (up to 1.5 million b/d) swings in China's monthly import levels. This gives it selective buying power.



Volumes and Budgets
The current conventional wisdom is that Iran will be able to increase its exports by about 500,000 b/d during its next fiscal year, beginning at the end of March. The preliminary budget which the Rouhani government submitted to the Majles last week estimated oil revenues at $22.5 billion, depending on price assumptions between $42-50 per barrel.

The budget estimates can't be taken as an indication of how much more oil NIOC actually believes it can export in the next Iranian year for at least three reasons. First, Rouhani won't want to overpromise additional revenues. Second, Iran doesn't count condensate or LPG as oil revenue. Third, the budgetary oil revenue figure may or may not include the 14.5% slice of revenue which goes to NIOC, or other allocations.

Market by Market
Iran's stated goal for market re-entry is for 60% of incremental barrels to go to Asia and 40% to Europe. With the exception of Turkey, all of Iran's crude exports now go to Asia. NIOC's desired portfolio of export destinations contrasts with Saudi Aramco's portfolio last year. Iran will of course remain barred from the U.S. market.



South Africa

NIOC's breakdown does not address which market South Africa is a part of. Ghamsari has expressed the hope that South Africa would be the first country to resume buying Iranian crude, after it joined others in reducing imports to zero in mid-2012.

Iran has inked a preliminary agreement with the South African government, but market re-entry there will probably depend on whether NIOC can re-establish Petronas' 135,000 b/d Engen refinery in Durban as a leading customer. It used to buy about 100,000 b/d of Iranian crude. Because of South Africa's location, prices offered to refiners there do not necessarily directly affect Asian or European price levels.

Targets in Europe

Iran has talked about Spain and Greece as potential marketing targets in Europe. Greece's top two refiners, Motor Oil Hellas and Hellenic Petroleum, are not known to have either an interest in or capacity to invest in Iran. But they used to buy more than 110,000 b/d of crude from Iran. NIOC might be able to make inroads into the Greek market if Iran is willing to tolerate higher Greek credit risk than other sellers.

This year, Spanish refiners have imported about 1.3 million b/d, with about 10% of that from Saudi Arabia and 4% from Iraq. Repsol has close to half of Spain's refining capacity. It withdrew from a Shell-led consortium to develop two phases of the South Pars gas project in 2010, but its executives joined Spanish ministers in a visit to Tehran earlier this month. Repsol is not a prime candidate to lead an investment consortium in Iran, however.

Ghamsari says that NIOC is eyeing Spain as well. "Efforts are being made to export oil to Spain at the same level as before the embargo, namely 200,000 b/d," he said. "We haven't agreed on a specific figure for oil exports yet, but, depending on the conditions, the previous figure could be realized."

EU Majors

Zanganeh has also targeted European majors like Shell, Total, and ENI. They do have the capacity to make major investments in Iran, but they are likely to look closely before they leap. Like others, ENI CEO Claudio Descalzi has stressed in his public comments that he will be studying the contract terms which Iran proposes for new investment, cautioning that there may yet be "deal-breakers".

While Iran wants to leverage upstream opportunities to help it regain market share, EU majors can also use their buying power to leverage better upstream terms out of Iran. If they do that, it could take some time to see who can out-leverage whom.

India's Private Refiners

In India, Iran's most important customer has been Essar Oil, but Rosneft's preliminary agreement to buy a 49% stake in the company raises new questions about supply deals. Rosneft has an agreement to supply Essar's Vadinar refinery with 200,000 b/d either from its own supplies or, more likely, from other sources, including from Iran. Rosneft also has agreed to make major investments in Venezuela, Essar's other major supplier. Essar buys very little crude from other Gulf producers except for Iraq.

The prize for NIOC in India would be regaining a relationship with Reliance, which hasn't bought any Iranian oil since 2009 partly because of U.S. political pressure. Reliance accounts for about one-third of Saudi exports to India.

In all of these markets, NIOC has different tools to help it regain market share rather than just relying on across-the-board discounting. The recent shift by Zanganeh and his colleagues away from threatening to bear "any cost" in boosting exports may have stemmed from a realization that a cavalier approach to pricing could put it and the rest of the Gulf producers at the mercy of a powerful swing buyer like Unipec.