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BULLETIN

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IRAQ'S INVOLUNTARY PRODUCTION CUTS

Iraq's oil production fell sharply last month because its exports fell, not the other way around. The export problem was mainly in the South and stemmed from SOMO's overpricing its heavier Basra crudes in an oversupplied market. Iraq is woefully short of storage capacity so it has to curtail production when exports falter.

In Northern Iraq, a different sort of problem is brewing: with both Baghdad and Irbil short of money, the long-suffering producing companies in the KRG are caught in the middle and getting screwed. The theoretically win-win deal Irbil and Baghdad reached on pooled exports in December leaves them out in the cold.

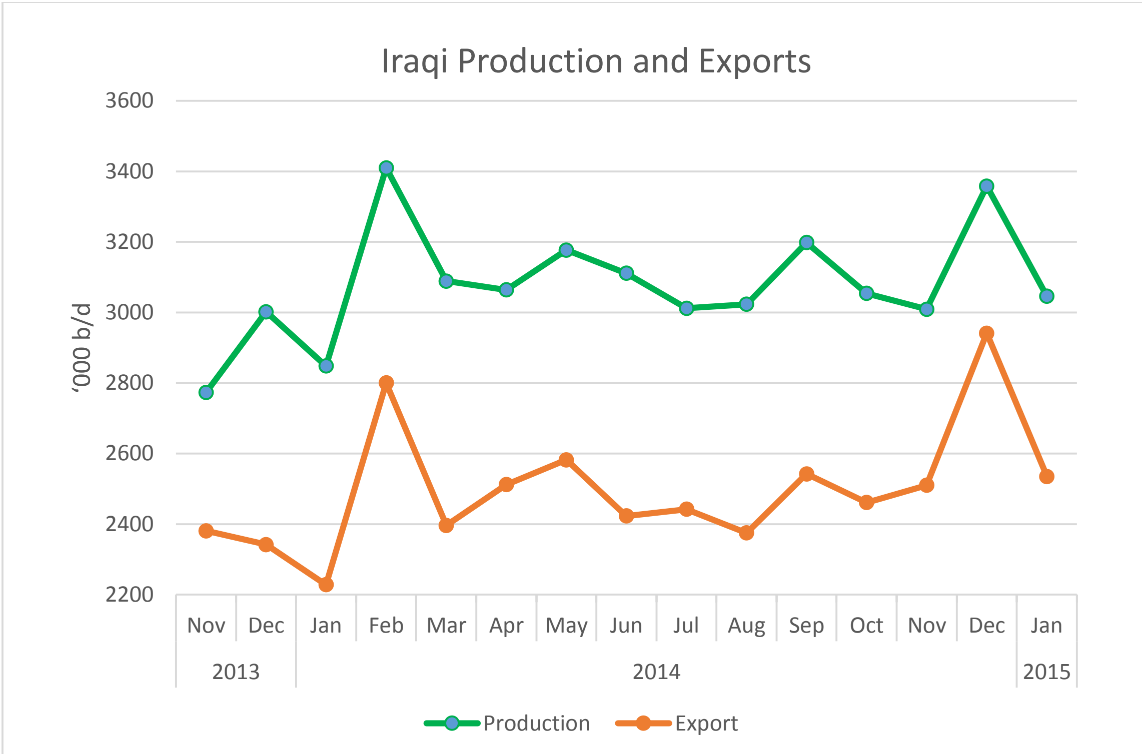
In the immediate future, they are shifting from exports via Turkey to sales to the local market, where any surplus crude ends up fetching a better price in Iran than it does in Turkey, thanks to the rapacity of well-connected Turkish middlemen.

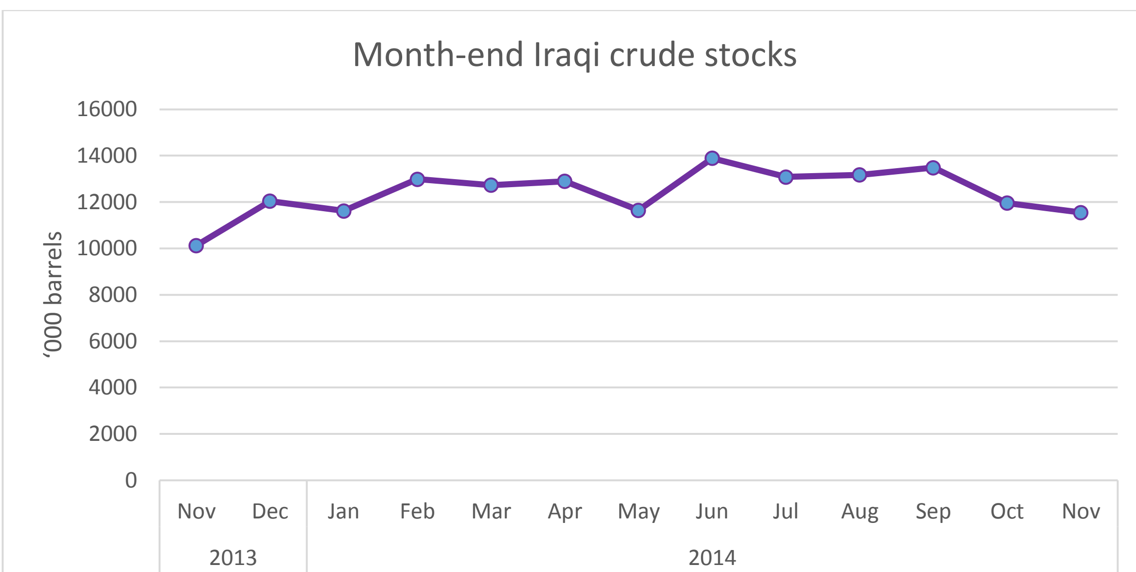
The companies, which have ramped up production so sharply in the past year, don't have the revenues to sustain ongoing investment that would maintain production capacity. At least one of them yesterday declared its investment in a once-promising field as "fully impaired."

January Production Down by 9.3%

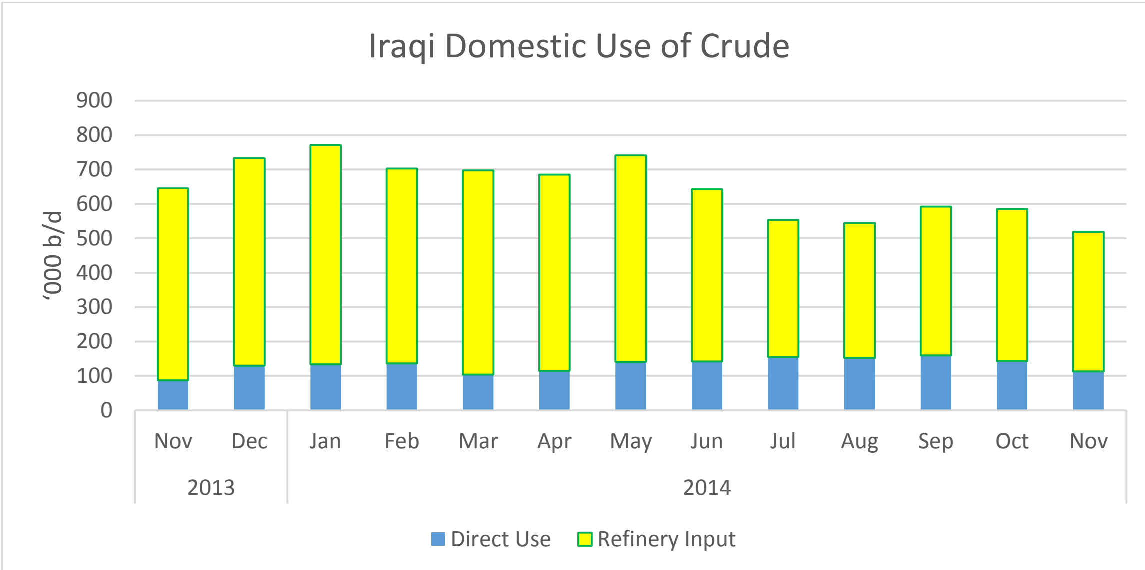
OPEC's monthly tally of its members' production, based on direct communications, confirmed yesterday that Iraqi production in January fell by 312,000 b/d, while earlier figures from SOMO showed exports falling by 406,000 b/d. The monthly production numbers Iraq reports to OPEC are the same numbers it later reports to JODI. The numbers do not include independent operations in the KRG.

Iraq's crude storage is limited: although its production is about 1/3 of Saudi Arabia's, the Saudis have 25 times more crude in stocks. That's another example of how much less operational flexibility Iraq has.





With the loss of the Baiji refinery in June, Iraq's domestic market for crude oil has been reduced.



"Baked in" Assumptions about Supply Growth

The decline in January production has been followed by warnings from industry leaders that lower prices will impact supply growth in Iraq proper and in Kurdistan. "It is very clear Iraq will not be able to deliver the quantum of production growth that is baked into people's supply assumptions," Genel's chief executive Tony Hayward told the annual International Petroleum Week conference in London yesterday.

In the KRG, producing companies are turning to local sales instead of exports via Turkey because they are not getting paid for exports. In addition, Canadian producer Talisman announced today that it was writing off--but not abandoning--its once promising Kurdamir field in the KRG, declaring its $234 million investment there as "fully impaired."

Previously, Talisman and its partners held out the prospect that Kurdamir might contain a billion barrels of recoverable reserves. One well there, spudded in late 2011, flowed at a rate of 3,400 b/d of 39 degree API crude.

Pooled Export Deal Not Dead

KRG Prime Minister Nechirvan Barzani met with the Federal parliament's Oil and Gas Committee earlier this week in Irbil in a continuing effort to overcome obstacles to the pooled oil export deal reached in December. In principle, it remains a win-win deal for Baghdad and Irbil, but it has left the operating companies in the KRG out in the cold.

Oil produced by these companies is meant to comprise 250,000 b/d of the 550,000 b/d which is to be exported from northern Iraq via the pipeline to Ceyhan. Since they have only been paid a fraction of what they are owed for oil already exported, they are looking to sell to local buyers in Kurdistan. Local refineries in the KRG can handle a limited volume of the oil sold there. Kurdish traders presumably export any surplus balances in their own trucks to Iran, where it may find an outlet in the Tabriz and Kermanshah refineries, not far from the border.

Iran's main export terminal at Kharg Island is about as far from the Kurdish oilfields as Turkey's Ceyhan. One KRG producer, Gulf Keystone, had been trucking its heavy Shaikan crude to Turkish ports--but at a steep cost. Last week, Gulf Keystone said it would be redirecting all of its 40,000 b/d of Shaikan from the Turkish route to local buyers, in part to save the reported $21 per barrel fees it had been paying to the Turkish company which had been trucking the oil. Apparently, the Turkish company refused to cut its charges in line with the lower price of oil.

"Local" Prices

The KRG Ministry of Natural Resources has taken some steps to make local marketing more attractive to the operators. But the local price, at slightly more than $30 a barrel for Tawke crude, remains at a steep discount to international prices. The MNR used to take 70% of the proceeds of local sales. Now it says it will only take 50%.

DNO Warnings on Impact of Lack of Revenue

The absence of payments for exports may soon start to affect productive capacity in the KRG. DNO Chairman Bijan Mossavar-Rahmani told investors last week that once the Tawke field hits 200,000 b/d, it will start its natural decline, perhaps at a typical rate of 10-15% per year. Tawke's gross production has been rising towards that 200,000 b/d goal, which is more than double 2014 production levels.

"At that point we will stop both to catch our breath but also to refuel in terms of revenues, and we are not going to be in a position to invest more until we are able to receive more in payments," Mossavar-Rahmani said. "That goes back to our adapting our spending to our earning and that's important to us and is important to the other producers in Kurdistan as well. Were we to go beyond that to the extent that revenues are coming in on a steady basis, there will be more work. Once we hit 200,000, as you know, the field will start a natural decline. What the rate of that decline will be I don't know. Typically, fields decline 10%-15% a year."

According to some published estimates, the three main operators in the KRG--Genel, DNO and Gulf Keystone--are owed more than $750 million for oil exports but only received 10% of that in November. Two of those operators together have more than $1 billion in debts.