AL MAJAL

Newsletter | March 2024

Our Updates

Al Majal Oil Field Services is pleased to announce the award of the new contract with a leading international oilfield services company operating in Basra, Iraq to provide (non-explosive) plasma cutters/punchers (Chammas brand). The Chammas Plasma Cutter is designed to cut stuck oilfield tubulars. This product serves the Oil & Gas industry by providing a clean cut when faced with pipe recovery work. Our plasma cutters are used worldwide by major Oil & Gas service companies to retrieve stuck tubing, casing, coiled tubing, and drill pipe.

AL MAJAL OIL & GAS ROUNDUP

IN COLLABORATION WITH QAMAR ENERGY

Latest in the Iraqi & Global Energy Markets

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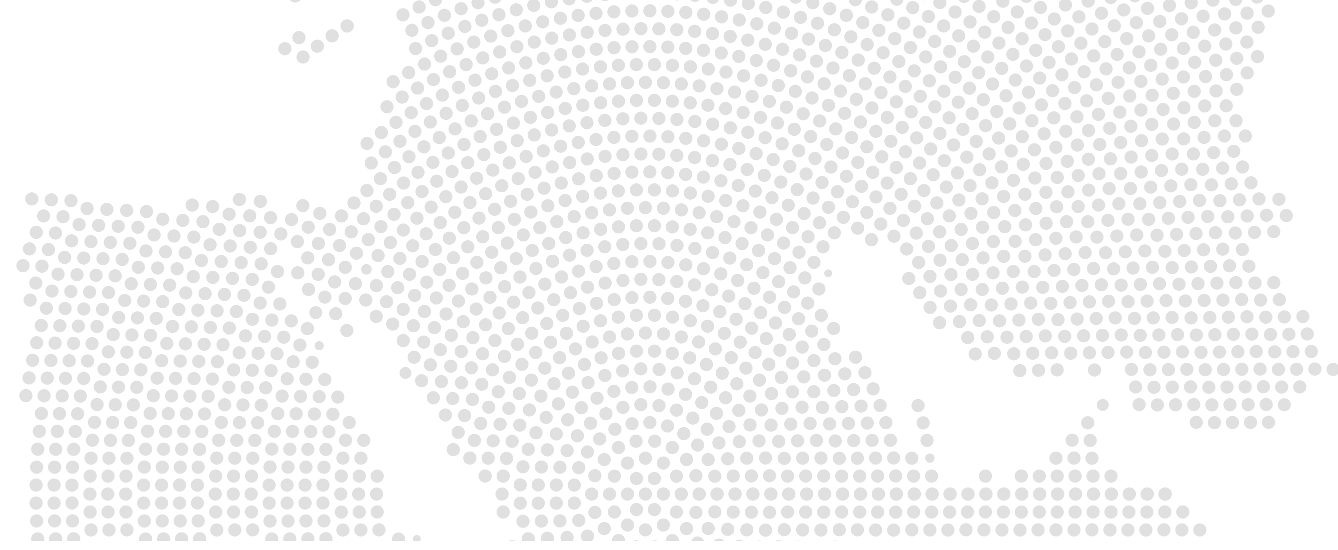
Oil Demand in the Middle East



Iraq's February oil demand witnessed a slight decline of 2.4% m-o-m from January 2024 at 896 kb/d, but still 9% higher than December 2022, indicative of an overall improved economy, requiring higher volumes of road fuels, primarily gasoline and diesel, and the return of fuel oil for generation, as gas exports from Iran were halted (due to shortages on the Iranian side). Iraq typically uses fuel oil, some crude oil and diesel for power, in the summer months due to the inability of local and imported gas to meet peak demand. The start-up of the 140 kb/d Karbala Refinery last year, the completion of a 70 kb/d expansion at the Shuaiba Refinery, **and the recent resumption of the North Refinery in the Baiji Complex after a decade** have also contributed to reduced oil products' imports, although continued "technical" challenges at Karbala mean the refinery is still running below design capacity. Bids for seven new refineries could also provide some upside to Iraq's domestic demand in the medium-term, although unlikely to have any major impact in the short-term, given that Iraq launched the bids only last year.

For the other major Middle East economies, oil demand declined 75 kb/d in February, as cooler weather and rainfall reduced power demand, especially for cooling needs. The start-up of the Al Zour LNG Terminal in 2021 in Kuwait has already cut the amount of crude oil the country uses to meet its peak summer demand.

Positive economic activity, led by higher manufacturing and construction activity, indicated by strong composite PMIs, primarily in the UAE and Saudi Arabia, and more air travel, are forecast to keep the region's annual demand elevated vis-à-vis 2023 and 2022. We expect 2024 demand from the region to average 4.6 Mb/d, 4% higher than 2023 figures, and 7% higher than 2022. Transportation fuels will also contribute to demand growth.

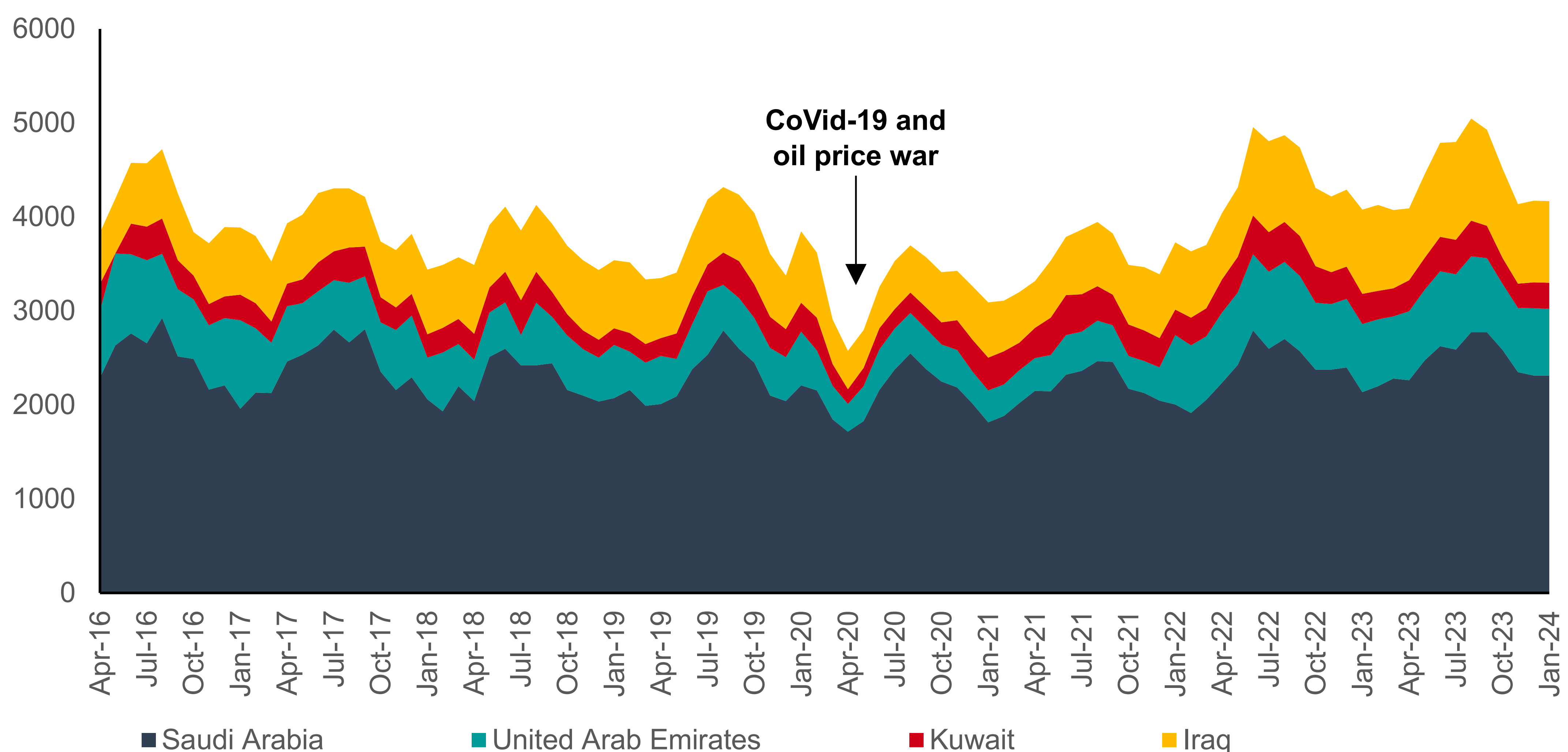


Figure 1 Oil Demand of Major Middle East Economies, kb/d

Iraq's Oil Production and Exports

The Iraq-Turkey pipeline (ITP) remained offline for the eleventh month straight, although overall exports increased by 05 kb/d from January, to bring total oil sales to 3.43 Mb/d from January's 3.34 Mb/d. **This is despite Iraq's lower OPEC+ quota starting January** which has been brought down to 4 Mb/d of production till March 2024 from the previous 4.22 Mb/d, and February having fewer days (which typically accounts for a lessening in the volumes exported compared to other months). **Increased exports were unsurprisingly the result of production breaching the quota limit in February**, with countrywide oil output increasing by 100 kb/d from January to reach 4.64 Mb/d, with incremental gains from nine fields across both Federal Iraq and Kurdistan.

Undercompliance with its OPEC+ quota is not unusual for Iraq, who typically tasks state-run fields to bear the brunt of cuts, while IOC-operated fields continue producing and in many cases expanding. In Federal Iraq, the main contributor to the increase in production was West Qurna-1 who increased output by 10 kb/d, while in Kurdistan, DNO has contributed to the slight uptick in production, with output from its Tawke field returning to pre-ITP shutdown levels of 80 kb/d, which is being routed to domestic market sales at extremely discounted prices of US$ 30-35/b. Seven other fields, mainly all in Federal Iraq, have also witnessed some incremental gains.

Production in February averaged 4.64 Mb/d, ~0.64 Mb/d higher than its OPEC quota, mainly due to KRI production recovering to >50% of its capacity since August 2023, but still lower than the record of >4.75 Mb/d recorded in January 2023 when the KRI was outputting at capacity. Most of the KRI's 14 producing fields are now operational again, although the reduced output is being sold in the domestic market at substantial discounts. Current production is just above 0.2 Mb/d, well below the February 2023 average of 0.43 Mb/d, the last full month of production before the ITP's closure.

The increase in federal production at a time when the country's OPEC quota has reduced means Iraq will continue betting on KRI's shut-in production capacity to be the main contributor to its overall compliance rate, even if not anywhere close to where it needs to be. In other words, a lower quota will contribute to higher undercompliance. Based on February's production figures, Iraq's compliance with its 3.99 Mb/d quota was a measly 38%, despite announcing just a few weeks prior that it would make up for past transgressions in coming months. Iraq has been pushing to increase production in the wake of global developments, including Venezuelan oil being taken off the market, tensions in the Red Sea increasing the risk premium of oil shipped through it, and a budget deficit that requires as much oil revenue as possible to be narrowed.

For the KRI, the lower quota could spell additional difficulties for in resolving the issues that are keeping its exports offline, as the quota would appear to reduce the sense of urgency in Baghdad to reinstate pipeline flows via Turkey, since offline volumes would allow it to maintain a "higher" compliance without compromising on output from its strategic southern fields. Federal Iraq has already "promised" to make up for its previous compliance transgressions over the next couple of months, which might not bode well for a resumption of northern exports. On the other hand, Baghdad is likely incurring substantial penalties to Turkey for not shipping committed volumes of oil through the ITP, in the range of US$1 M per day.

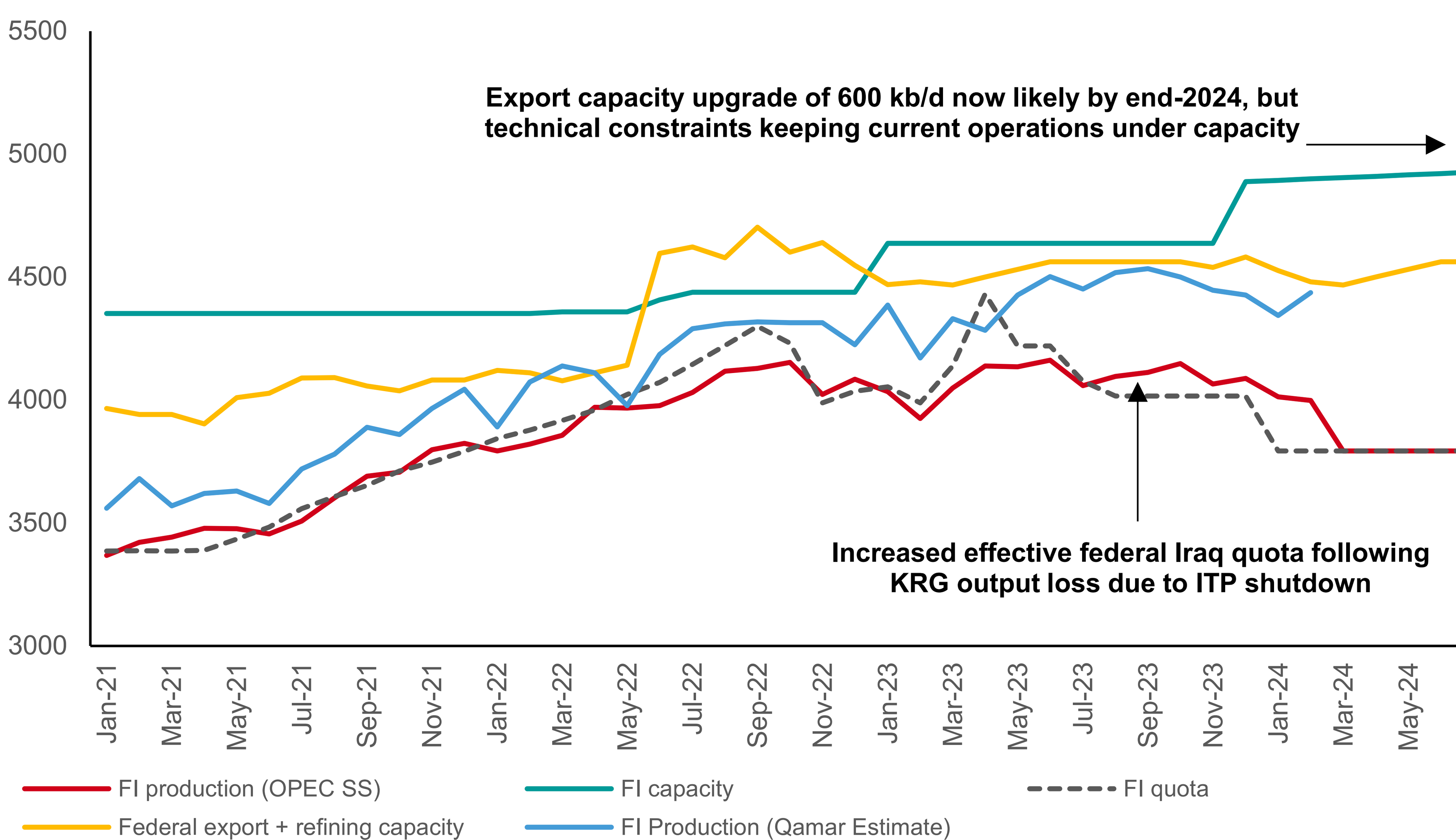
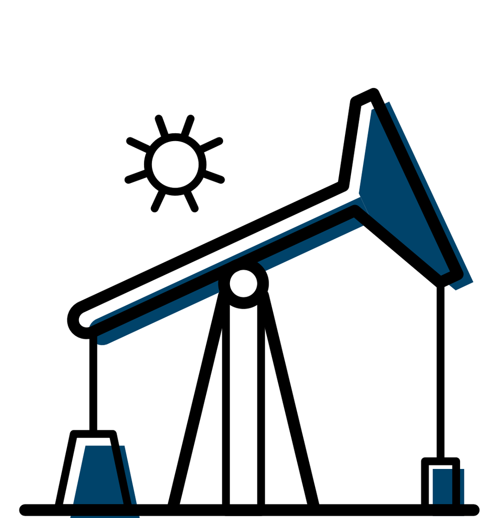


Figure 2 Federal Iraq production vs capacity, kb/d



Revenues from February exports clocked in at US$ 7.96 B, slightly lower from January's US$ 8 B earnings, despite global oil prices increasing 4% m-o-m, but mainly due to February having fewer days. Federal Iraq typically prices its crude to international markets at a 3-5% discount to Brent. Current international oil prices are hovering around US$ 86/b, which should also be reflected in pricing for March-loading cargoes. Exports are expected to continue flowing solely from the Basra Gulf for the next 3 months, till a definitive decision on the resumption of the ITP is reached. This raises concerns over Iraq's ability to maintain its southern export infrastructure's maximum sustainable capacity or risk bottlenecks that could shrink valuable export flows. It also continues Iraq's complete dependence on the insecure Red Sea or the longer route around the Cape of Good Hope for its shipments to Europe.

Plans for a new 2 Mb/d, US$ 416 M offshore pipeline by 2025 under contract with Dutch company Boskalis are also yet to be finalised, with financial negotiations expected to be the main sticking point – in any case, it is highly unlikely that the project could commit to a 1-year timeline given Iraq's bureaucracy.

If the ITP does resume operations, production from the Kurdistan Region would likely increase towards preshutdown levels, and Iraq might face a challenge in balancing its commitments to the OPEC+ coalition, forcing it to either reduce federal production, or exceed quota limits, potentially dampening global oil prices, which could impact the revenues coming into the country.

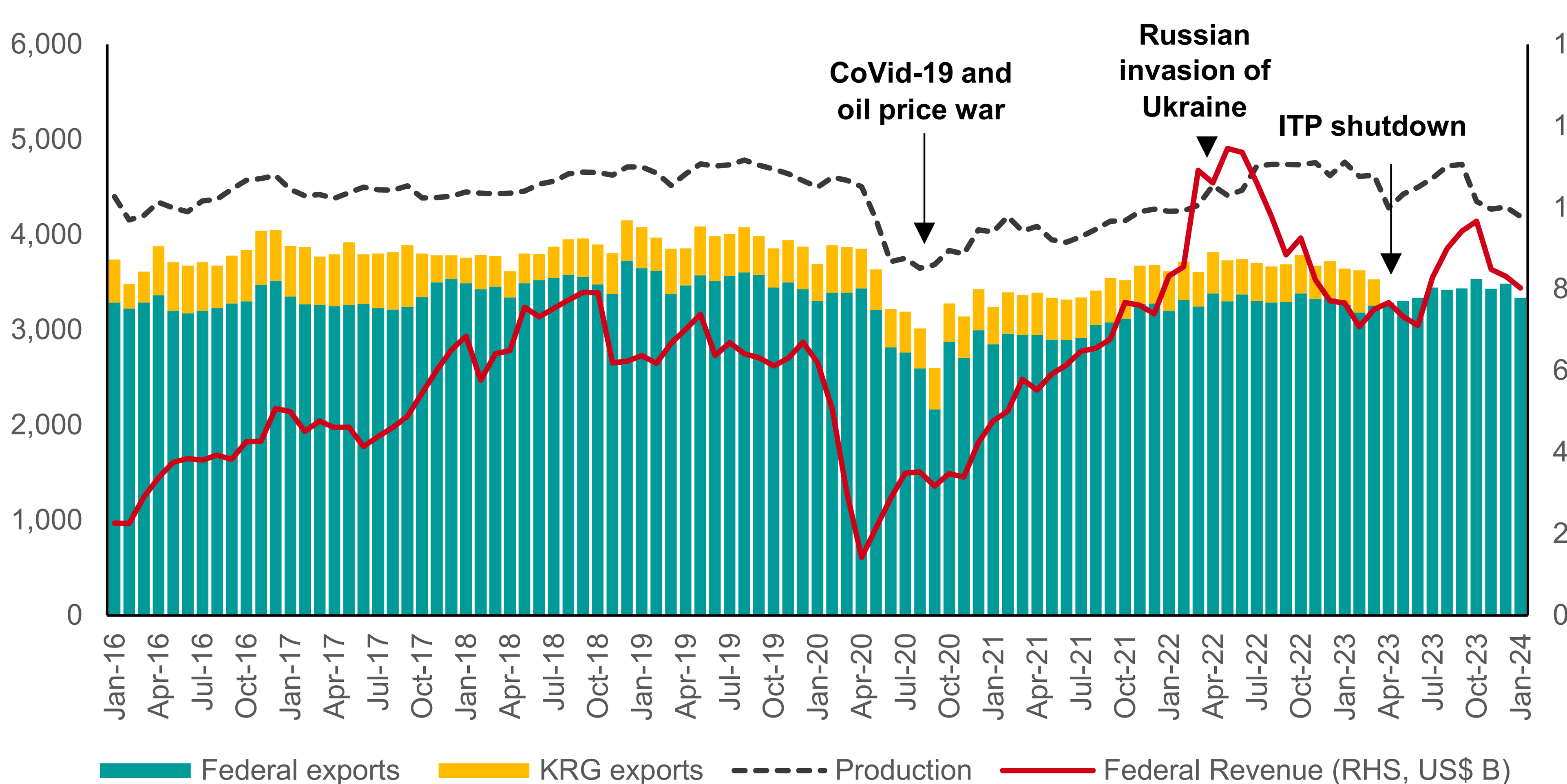
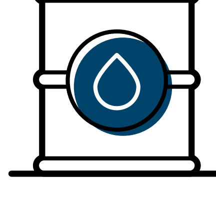


Figure 3 Iraq production vs exports, kb/d

Iraq's Oil & Gas Developments

A New Oil Products Swap Deal Could Help Iraq Pay for Iranian Gas



Contractually, Iraq imports ~20 BCM of gas from Iran per year (the gas import agreement was renewed for another 5 years on March 27), but has been unable to make regular payments for these, resulting in billions of dollars in debts, mainly due to the US sanctions impacting banking restrictions, as well as limited funds in its own coffers after earned oil revenues are withdrawn by government for domestic spending and investments. Estimates for the debt Iraq owes Iran range between US$ 11-12 B, and have remained pending over the past year, resulting in Iran repeatedly cutting off the gas (and electricity) it exports to Iraq, often at times of peak demand, which worsens Iraq's electricity crisis.

Despite contract terms stipulating an oil-linked import price with a slope between 11-12%, Iraq has often paid lower than what imported volumes would require on paper, due to some concessions on Iran's side who is much harder pressed for cash and would agree to a lower payment as long as it meant it had a meaningful source of revenue. Already there are some speculations that it has recently cost Iraq US$ 4 B per year to pay for contracted gas volumes from Iran, meaning the gas import price is lower than what contract terms had initially established. This time around, Iran has been less willing to concede to Iraq's troubles with paying up, and has arrived at a new deal under which Iran will nominate domestic companies to load oil products from refineries in Iraq. Once these products are sold, Iran will be paid, rather than Iraq, with the amounts offset from Iraq's ongoing debt to Iran.

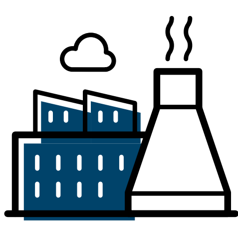
Iraq will be responsible for communicating the sale value of its oil products to Iran, who will then deduct that amount from the debt owed, once international customers pay Iran. This arrangement was okayed by the Iran government and the Coordination Framework, an alliance of Iraqi political parties backed by Iran, with a strong influence on the current Iraqi government.
Still, it is unclear whether such an arrangement could really yield the benefits it purports to do. For one, evenif Iran were selling Iraqi oil products from its own nominated domestic companies, international buyers would still run into issues with banking and financial transfers, if they lifted such product, due to the sanctions imposed by the US. If the companies paid directly to Iraq, then Iraq would face the same trouble as now, with being unable to send over the payment to Iran due to banking restrictions.

Iraq has allegedly been depositing the money it owes Iran into the National Iranian Gas Company's account at the Trade Bank of Iran, which Iran has not been able to repatriate. The new arrangement seems to circumvent this problem, but might already fail, seeing that international customers have more or less moved past trading with Iran, except China, who would demand substantial discounts on any oil products lifted. Since Iraq will be informing Iran of the sales value of its oil products, it would naturally want these products to trade at the sales value, so that it can clear its debt to Iran as soon as possible, rather than have to swap increasing volumes of oil products that sell at lower prices, increasing the time it would take for the debt to be cleared.

The financial benefit to Iran, meanwhile, will also at best be minimal, since its own crude and oil products are selling to only a few customers and at massive discounts to international benchmarks (which Iran has been trying to undo by a few dollars per barrel every few weeks, but still remain significant). Also, the arrangement requires the companies nominated by the Iranian side to be "approved" by SOMO. Since almost all of Iran's energy trading companies are blacklisted by US sanctions, it will be difficult to ascertain which companies SOMO could actually approve without running into tensions with the US. At the moment, SOMO has signed five preliminary contracts with companies nominated by Iran to receive HFSO that Iraq produces a lot of (due to lack of modern refining equipment to generate IMO-compliant fuel oil), which Iran will then sell for use as bunker fuel to buyers willing to further process it, who burn it in power plants or industries such as cement, or who use scrubbers or don't mind running afoul of IMO considerations.

Still, friction with the US is a risk for Iraq, since the US could argue that the arrangement does not appear to provide any guarantee that the revenue will be used by Iran for only humanitarian purposes. Whether this arrangement can take off meaningfully, therefore, remains to be seen.

Federal Iraq and IOCs Continue Trading Allegations over the ITP, Threatening Recent Progress towards Possible Resumption



Following recent statements from the Association of the Petroleum Industry of Kurdistan (APIKUR, an association founded by IOCs in the KRI to represent their interests and further the region for oil and gas investment) claiming the federal government had not "taken the required actions" to reopen the ITP and that "there has been no real progress" despite meetings between Baghdad, the KRG, and KRI-operating IOCs, the federal government has now come out to say that IOCs operating in the KRI are "partly" to blame for the delay in resuming crude exports since they have failed to submit their contracts to the federal Ministry of Oil for revision.

Revising the KRI's production sharing contracts (PSCs) to Federal Iraq's 2018-amended profit-sharing model has been a sticking point for IOCs in Kurdistan, who believe that they will not be able to earn as much profit as they do under their PSCs, not least because the cost of production of Kurdistan's oil is far higher than in federal Iraq, where majority of oil production is concentrated in the south of the country with much more favourable geology, supporting better economics. This is despite Federal Iraq formally acknowledging in recent weeks that the budget provision of US$ 6/b for oil produced in the Kurdistan was much too low, and conducting negotiations which would see this increased to US$ 21/b. For the IOCs' part, they have insisted on a per barrel cost of not less than US$ 25/b, highlighting that costs are usually as high as US$ 30/b.

The coordination framework for resuming Kurdish oil exports through the ITP had as one of its primary objectives the transfer of all oil and gas contracts with the Kurdish MNR to the Federal MoO, which Erbil had begrudgingly seemed to accept (despite no formal endorsement) due to the extremely challenged financial situation it finds itself in since the closure of the pipeline, placing it at the mercy of the federal government to meet its financial obligations. This has led to IOCs feeling "isolated" by the KRI who has understandably prioritised acquiescing to Baghdad's terms for access to federal funds, over representing IOC concerns in a manner that could risk that access. One of the reasons for the formation of APIKUR was to be able to lend a unified voice to IOCs who felt that the KRI might not be able to adequately and appropriately represent them in negotiations with Baghdad.

Talks around contract amendments therefore seem to have entered a stalemate, which does not bode well for the future of Kurdistan's oil and gas sector. APIKUR says its member companies' "current commercial terms and economic model must be maintained", while the federal Ministry insists on the transfer of all KRI contracts to the profit-sharing model. So far, there does not seem to be any indication of a near-term resolution just yet (with a recent parliamentary session for reviewing the oil and gas framework once again delayed), but the decline in KRI's production to about 50% of its capacity, and domestic sales at extreme discounts will begin to exert significant pressure on IOCs who are already struggling to cover costs. This could result in either them exiting the region (if they do not feel convinced that they could get the federal Ministry to agree to their requests), or accept Baghdad's terms, which might result in lower profits than those they are used to.

In any case, the failure of both sides to reach consensus on resumption of an important export outlet, which, pre-closure was helping meet 0.5% of global supply, casts a negative light on future investment prospects in Kurdistan, with extremely lucrative assets (including for natural gas) at risk of remaining undeveloped.

Federal Iraq Planning New Bid Rounds in H1 2024 with Key Sweetener Investment-Friendly Amendments to Previous Profit-Sharing Contract Model

With natural gas development a key priority for Baghdad to meet Iraq's burgeoning energy needs, the Ministry of Oil is preparing for new bidding rounds in April and May in efforts to develop new non-associated gas resources, while at the same time expanding flare capture at existing oil fields. Under a "5-year plan" for the gas sector, IOCs operating in federal Iraq will gradually increase associated gas production at their respective fields, with work currently underway on projects in PetroChina-operated Halfaya and Nahr bin Omar, and deals already concluded with TotalEnergies for the Gas Growth Integrated Project and under negotiations with US-based firm KBR who might develop yet-to-be named oilfields.

The two new bid rounds – the fifth licensing round 'plus' (LR5+) and the gas-focussed sixth licensing round (LR6) – will offer 30 blocks across Iraq with some "key sweetener investment-friendly amendments" to its 2018 profit-sharing contract model (a departure from Iraq's tight terms under the technical service contracts offered in the past), although the presence of blocks bordering Syria and Jordan might not receive enough interest, due to ongoing security risks and geological uncertainties. The assets set to be offered up are relatively modest compared to offerings of past licencing rounds, including several previously-discovered but undeveloped fields, some of which are decades old. This is probably why Iraq is considering amending its contract model to guarantee investor interest, with a "Definitive Model Contract" to be issued on 04 April for both rounds.

Still, the envisaged timeline could be pushed back, which is typical for Iraq, although officials have mentioned that IOCs themselves are asking for more time and information to prepare their economic assessment of the blocks on offer. Some of the amendments being considered for the contracts include royalties being cut from 25% to 15% as a key "improvement to the benefit of investors". The lower royalty indicates Iraq's willingness to let IOCs keep a higher share of output in recognition of the technical and commercial risks in developing the offered blocks.

Other changes will allow investors to recoup their costs early and reach remuneration faster by downsizing minimum spending obligations, while replacing a fixed commercial production target with a percentage of the plateau production target, allowing more flexibility to operators without having to undertake complicated procedures to amend fields' master development plans (MDPs) in case the decided production target is no longer feasible. The contracts' exploration phase might also now be extendable to nine years from the previous five years (with a single two-year extension allowed), while the development phase is set for 20 years, extendable by 5 years as in the existing model.

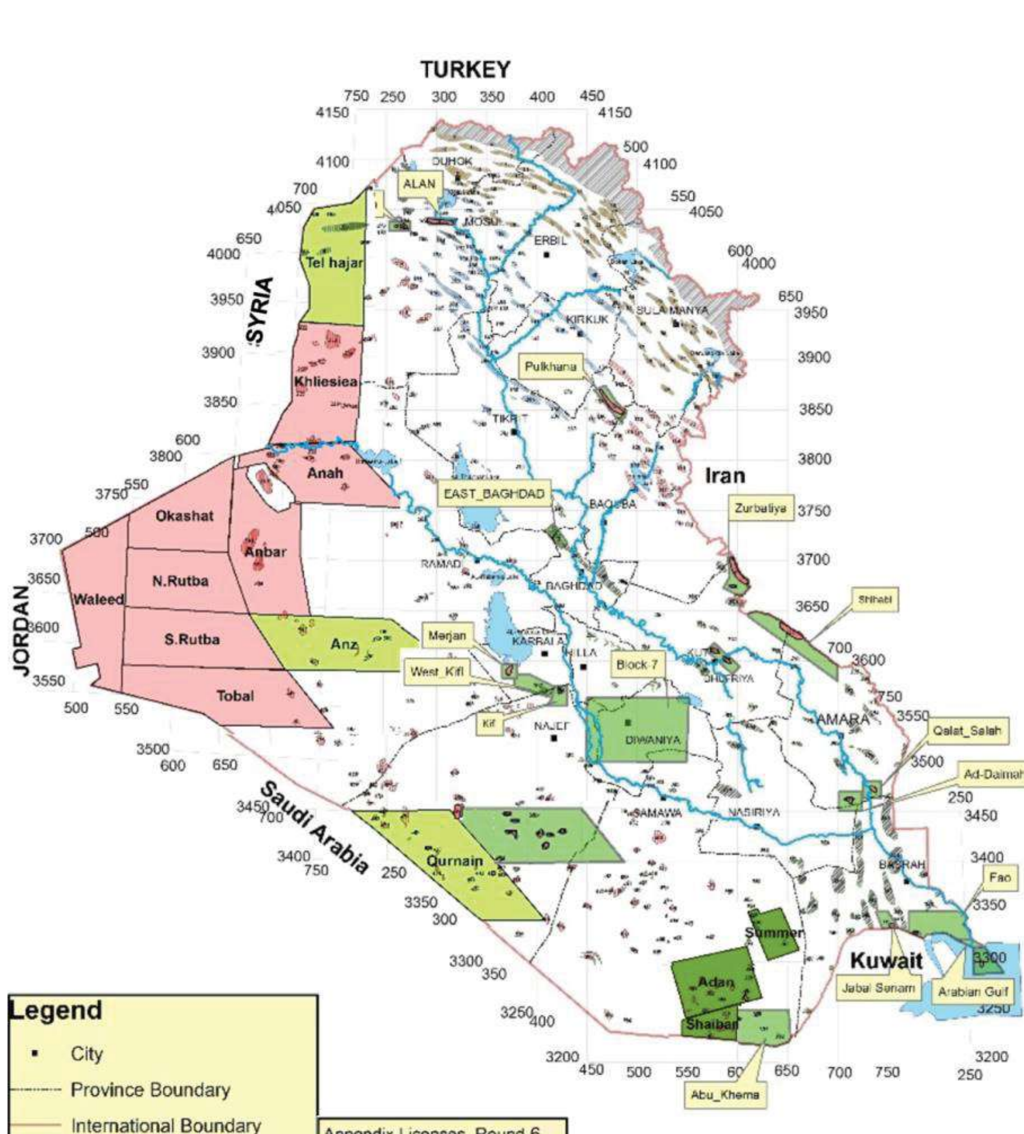


Figure 4 Iraq's New Bidding Rounds

Investors could also monetise gas under new "take or pay" clauses even if offtake infrastructure is not available, although it is not clear yet how exactly this would work, and if gas would be collected at a common point for lifting, given that a lot of assets on offer are clustered together. A possible solution is in the incentive for contractors who will be entitled to recover with interest their expenditures categorised as supplementary costs, covering additional facilities and services offered beyond the scope of the recoverable costs contractually specified. This could allow the Ministry of Oil to task firms with building the necessary gas infrastructure to connect developments with the country's gas network while allowing them to recover the related spending.

Offering better terms under the contract model might be Iraq's way of attracting interest from international investors other than China, but the main question remains whether Western firms will be interested, especially since the assets on offer are mostly large, far away from existing infrastructure, and potentially with outdated and incomplete information of their own. Security concerns also remain a risk, with western firms hesitant to commit to Iraq in the wake of militant activity in the western regions. It may be more likely that investors turn their attention to the other offerings in oil-rich central and southern Iraq, with assets elsewhere once again turned down for development.

TOP ENERGY DEALS IN THE MENA REGION

Project

HYPORT Duqm Green Ammonia receives Pre-Certification

Client / Buyer

Contractor / Seller

DEME, OQ

Implications

- HYPORT Duqm, a green ammonia project being developed in Oman by Belgium's DEME and Oma's OQ has secured a crucial certification from CertifHy. This certification makes its renewable ammonia eligible for export to European Union markets, marking a significant step towards sustainable energy trade
- The certification indicates compliance with the European Renewable Energy Directive II (RED II). This pre-certification signifies that the green ammonia produced at Duqm will be recognized as Renewable Fuels of Non-Biological Origin (RFNBO) in the EU
- The collaboration between the Belgian Federal Public Service's Energy Transition Fund (ETF), Hinicio, and TÜV SÜD in the pilot highlights the global effort to transition towards cleaner energy sources

Iraq Oil Market Highlights

Crude Oil Prices

As of March 15th, 2024

WTI: USD 85.20

Brent: USD 90.00

Iraq Rig Count

March 2024: 59

February 2024: 59

Iraq Oil Exports

March 2024: 3.342 Mbpd

February 2024: 3.39 Mbpd

Oil Exports Revenue

March 2024: 8.70 USD Billion

February 2024: 8.03 USD Billion