



IOCs heading in different directions in MENA

International Oil Companies (IOCs) have long played a dominant role in the development of the region's oil sector – and have always seen the Middle East's vast reserves as the prized asset. Competition amongst them has always been fierce; but more recently, structural changes in the oil market, political uncertainty and the emergence of shale in North America is changing the way IOCs view the Middle East.

The Middle East has always been an important region for the IOCs, thanks to its vast and cheap-to-extract reserves. Companies like ExxonMobil, BP, Shell, and Total have competed in countries like the UAE, Iraq, and Iran. Their interest in the region has always been strong and their presence has spanned many decades. However, the scene has fundamentally changed over the last few years, prompting IOCs to rethink their strategy in the Middle East. US majors ExxonMobil and Chevron are focusing more on their investments in North America, where they see more value and quicker returns. BP has been selling off assets to settle the Deepwater Horizon oil spill claims, while Shell's recent takeover of BG is making its Middle East position less clear. Only Total is showing clear commitment to expand its portfolio in the region.

Multiple factors and trends have led to such a rethink. Falling oil prices and capital discipline has impacted overall investment, and the emergence of US shale offering new opportunities in the unconventional sphere have upset the previous dynamics of supply and demand; meanwhile the unattractive fiscal terms on offer have caused some IOCs to reconsider their position in key producing countries. Furthermore, competition from Asian players for limited opportunities, the international sanctions on Iran that have forced many companies to leave the country and heightened geopolitical uncertainty have all contributed to the change of approach.

Shell's position in the Middle East remains unclear

Shell's recent \$70bn takeover of BG has turned its attention to restructuring its business and focusing on existing assets. The company is sending mixed signals about its desired role in the region. It decided against renewing its stake in the ADCO concession, but refused to rule out a return. It also withdrew from the \$10bn Bab sour gas field in the UAE. On the other hand, it is expressing interest in Iran and Shell is one of the 29 prequalified companies that will be allowed to bid for upstream contracts. It signed an MoU to study the South Azadegan and Yadavaran fields, in addition to the Kish gas field. Shell's presence in Iran before sanctions will put it in a favorable position if it decides to bid for some of the fields.

The picture is different in Iraq, where Shell is looking to sell its stakes in Majnoon and West Qurna 1. The company has a 45% stake in Majnoon's 220k b/d field and around 15% in the 450k b/d West Qurna 1. If this happens, the company's main oil-producing asset will be Petroleum Development Oman, where it owns a 34% stake in the 600k b/d company. Shell's desired departure from Iraq's oil sector is a testament to the more challenging financial environment and the unattractive terms on offer, as IOCs effectively operate as contractors for the

government and receive margins of under \$2/b. However, Shell is heavily involved in the country's gas sector and holds a 44% stake in the Basrah Gas Company. The 25-year joint venture commenced in 2013 with the aim of capturing the country's flared associated gas.

BP recovering lost ground

Over the past six years, BP has focused on recovering from the Deepwater horizon spill in 2010. The company was forced to sell in excess of \$40bn worth of assets to fund payouts. But after a difficult few years, BP is beginning to invest again. It recently acquired a 10% stake in the ADCO concession, having been part of the old concession that expired in 2014. The 1.66m b/d concession will run through 2054 and will also involve Adnoc (60%), Total (10%), Inpex (5%), and GS Energy (3%). Having been adamant that a \$2.2bn signing fee is excessive, it structured the deal in a way that allows the company to raise capital by giving the Abu Dhabi government approximately 2% of its shares, with estimates suggesting that those shares are worth around \$2.3bn.

The deal reinforces BP's commitment in the UAE, and more specifically, to low cost barrels. The company's share of the ADCO concession is estimated to be 165k b/d in 2017 and will send the company's Middle East output to around 400k b/d. Additionally, BP has around 96k b/d from its 14.67% share in the Adma concession where it intends to remain beyond the concession's expiration in 2018.

But the recent increase in its oil output is mainly attributed to Iraq where BP receives its payments in oil. In Iraq, BP was the first major to return in 2009 when it was awarded a 25-year technical service contract for the large 1.35m b/d Rumaila field. BP (47.6%) partnered PetroChina (46.4%) and State Oil Marketing Organization (6%) for the project. In Oman, BP is investing heavily in the Khazzan tight gas field, with development costs of around \$16bn. The field is one of the region's largest unconventional gas fields and is expected to begin producing by the end of 2017 with a production target of 1bcf/d. BP has decided to remain out of Iran for now, with political uncertainties cited as the main reason.

Total showing the most commitment

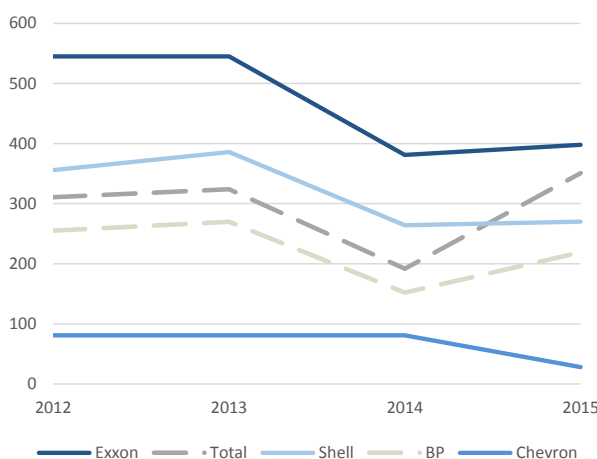
Total is arguably the IOC most committed to investing in the region. It was the first to sign up for the ADCO renewal in 2014, agreeing to pay a \$2.2bn signing fee. It also recently replaced Maersk in the 300k b/d Al-Shaheen field in Qatar while in Iran, it is aggressively pushing for deals in the upstream sector. Total is now the second largest IOC in the region in terms of liquid output, recently overtaking Shell when the latter opted against

renewing its stake in ADCO. Although production figures haven't changed much recently, Total has been busy signing deals to boost future production. Unlike the other majors, Total is focusing more in the Middle East in pursuit of cheap barrels, which has long been the cornerstone of its strategy. Even though focusing on the Middle East exposes the company to geopolitical risk, Total believes that other reserve bases such as US shale pose a 'market risk'.

The company's involvement in ADCO has been significant since it signed up in 2014. This is mainly because it had to step in temporarily and operate some fields as asset leaders in the absence of other major IOCs in the concession. In Qatar, Total replaced Maersk in the 300k b/d offshore Al-Shaheen field. Although a more geographically challenging field, production costs are below \$10/b. Total's ambition to be the dominant IOC in the region is evident by its desire to play a significant role in Iran. Recently, it signed an HoA for the development of Phase 11 of the South Pars gas field, at an expected cost of \$1bn. Total has experience in Iran and is familiar with the Qatari side of the field. It also signed an MoU with Shell and Petronas to study the South Azadegan field to boost oil recovery from 5.5% to 20%.

In Iraq, the challenging environment has kept the company's presence small. Its involvement there is mostly limited to the Halfaya oil field, where it has a 22.5% stake in the consortium, averaging 18k b/d in 2015. Additionally, Total has some interest in several exploration blocks in Iraqi Kurdistan. While it wants to be more involved in Iraq, Total feels that it needs to seek better financial terms before it invests further in the country. In the rest of the region, the company saw some investments falter in recent years. Its assets in Syria and Yemen are non-operational due to the ongoing civil wars, with resumption unlikely to happen anytime soon. Despite this, Total's appetite for the region seems to be growing.

IOC production share in the GCC (k b/d)



Source: MEES

An uncertain role for IOCs

While IOCs continue to play an important role in the Middle East, we observe several factors that are setting the scene and making them rethink their strategies in the region.

First, in an environment of declining capex, IOCs are increasingly focusing on low cost barrels. Total used the low price environment in the past two years to reduce its cost structure and secure deals and projects that produce low cost

barrels. Total is pushing to become the dominant IOC player in the region despite the heightened geopolitical risk.

Second, some IOCs no longer see the Middle East as their preferred destination. ExxonMobil and Chevron are diminishing their roles in the region, and decided against participating in Iran. Both companies are focusing more on their US operations. According to Chevron's CFO, "the value of the Permian – its tremendous economic capability and its capital efficiency, its great flexibility, its short cycle/high return attributes ensure that other parts of the portfolio have to compete for capital against that."

Chevron's main involvement in the Middle East remains the Saudi-Kuwaiti neutral zone - with no indication that it wants to expand its regional presence. Currently, Chevron's regional production has fallen to zero as production from the Saudi-Kuwaiti neutral zone remains shut. Chevron initially wanted to play a role in expanding this capacity, but with increasing focus in the Permian, it is likely to rethink its strategy. ExxonMobil didn't renew its stake in ADCO after the 75-year concession expired in 2014, and repeatedly said that it doesn't want to go back. It does, however, continue to operate in the UAE with its 28% stake in 670k b/d Zadc.

Third, IOCs are still wary of entering Iran over fears of violating regulations and risking heavy fines. Iran has made some progress with international shipping and insurance companies; but US residual sanctions are still in place, limiting access to international banking services. Many firms had reservations prior to the elections and are now seeking clarity over the US administration's 'Iran policy' before committing. Iran also runs the risk of having sanctions re-imposed under the 'snap-back' provisions in the event of non-compliance. Companies that were operational in Iran before sanctions like Total will be especially wary of this.

Finally, the type of contracts will be key in attracting IOCs. Some of the largest reserves in Saudi Arabia and Kuwait are not open to foreign players and IOCs like Shell, ExxonMobil, and Total have had their involvement limited to some technical service agreements, technical studies and R&D. The real potential remains in Iraq and Iran though the opportunities are limited. IOCs in Iraq are usually offered low margins, and essentially operate as contractors. This has been the main reason behind Total's small presence in the country, while Shell is considering selling its stake in Majnoon and West Qurna 1. In Iran, the IPC has replaced the unpopular buy-back contracts but it remains unclear how attractive are the new terms on offer. 29 IOCs have prequalified for bidding later this year, of which 15 were Asian companies.

What are the implications? The most obvious lie in Asia: as it remains the Middle East's top export destination, its players will likely want to fill the void left by some of the Western majors. Companies like CNPC are putting the Middle East – particularly Iraq and Iran – at the forefront of their global upstream strategy. This makes good sense, given that Asia is the main importer of the region's oil. Middle Eastern governments will also be keen to build stronger ties with Asian countries, the main source of demand growth for their commodity.