SPECIAL FEATURE

Rewarding the bold

A primer on Kurdistan's independent E&P companies

AUTHOR
David Graves,
Senior Restructuring Reporter
44 (0)20 3741 1050
david.graves@acuris.com

25 July 2017

When independent oil and gas producers based in the semi-autonomous **Kurdistan Region of Iraq (KRI)** turned to the bond market between 2007 and 2015, fixed income investors welcomed the opportunity to gain exposure to vast untapped reserves. But the honeymoon didn't last – by 2016, three of the five bond issuers with operations in the region had renegotiated their debts.

The companies were battered by the commodity price collapse, with the oil proving neither as plentiful nor accessible as once thought, and the Kurdistan government's struggle to make payments while funding a war against ISIS. The region's ability to generate revenues was further hit when the main export pipeline, running from Kirkuk to Ceyhan in Turkey was closed for a short-period in early-2016 following militant attacks.

However, with ISIS on the backfoot and payments for oil being made more regularly, could it be time to reassess these credits?

The toll of war

"*The security situation has never been a [direct] problem for the oil and gas companies in Kurdistan. The main issue is a lack of cash and a lack of investment,*" said Alan Mohtadi, CEO of risk consultancy T&S Consulting. "*It may sound strange, but Kurdistan is safer than some parts of Europe.*"

Kurdish Peshmerga forces have largely succeeded in preventing ISIS encroaching into KRG territory and the expulsion of the terrorist group from the Iraqi city of Mosul may mark a turning point in the conflict. However, for some years funding the gruelling conflict took priority over paying oil and gas companies, leaving the KRG with vast arrears to the independent E&P companies in the region.

Production and export volumes have increased notably over the last few years and – despite the threat of litigation by the Government of Iraq against those who purchase oil directly from Kurdistan – the Kurdish administration has been successful selling abroad everywhere except North America, said Mohtadi. Giant commodity traders **Vitol**, **Glencore**, **Trafigura** and **Petraco** all have been facilitating the sale of Kurdish oil.

Overall KRI production stood at just over 300,000 bbl/day in 2014, jumping to around 575,000 bbl/day in 2015, according to a *RBC Capital Markets* research note published in May, while exports grew from around 130,000 bbl/day in 2014 to some 380,000 bbl/day in 2015. The KRG should now, for the first time in two-years, have underlying positive cash flow, according to a *Pareto* research note published in March.

Prepayments take the edge off

The traders have also taken to providing the KRG with substantial prepayment facilities, alleviating the region's immediate financial crisis. Notably, Glencore structured a USD 500m facility into the tradable Oil Flow 12% 2022 notes, issued in January. Earlier this year, Russian oil behemoth **Rosneft** became the first major oil company to join the trading houses and pre-pay for oil purchases.

As a result, the KRG has been able to make regular payments to oil companies, which since February 2016 has included an added 5% revenue linked payment to repay owed receivables.

In April, a spokesperson for Kurdistan's natural resources ministry said debts owed to oil companies reduced by a quarter over the preceding eight-months, from USD 4bn to USD 3bn. **DNO** claims it is owed some USD 1.1bn in receivables, the *RBC* note said. **Genel** says it is owed a nominal value of USD 515.9m at end-2016, roughly stable Year-on-Year, the company told *Debtwire*.

OUTSTANDING DEBT INSTRUMENTS

Issuer	Maturity	Size (USD m)	Coupon	Price (at 25/07/17)	YTM	Capital structure
Dana Gas	Oct-17	USD 350m	9%	79.63	108.69%	Ordinary secured sukuk
Dana Gas	Oct-17	USD 340m	7%	80.50	100.93%	Convertible secured sukuk
DNO	Jun-20	USD 400m	8.75%	96.32	10.25%	Senior unsecured
Genel	May-19	USD 422m	7.5%	87.11	16.01%	Senior unsecured
Glencore Oilflow Bond	Jan-22	USD 500m	12%	104.75	9.93%	Structured prepayment notes
GulfKeystone	Oct-21	USD 100m	10%	100.00	9.99%	Reinstated notes, PIK option at 13% until Oct-18
ShaMaran	Nov-18	USD 150m	11.5%	79.00	32.50%	Senior PIK notes
ShaMaran	Nov-18	USD 18m	11.5%	n.a.	n.a.	Super senior PIK notes

Source: Debtwire, bond prospectuses, Markit

Meanwhile, Pearl Petroleum – 35% held by **Dana Gas** – is struggling to recoup a USD 2bn arbitration award against the KRG, which the government continues to contest. The dispute revolves around delays in the development of the Khor Mor and Chemchemal gas fields. A LCIA hearing in September will determine the final damages award, which Pearl claims could be as much as USD 26.5bn.

The growing appetite to invest by international oil behemoths suggests increased confidence in the region. Rosneft is reportedly in discussions to develop oilfields disputed by Iraq and Kurdistan, while a major US-based international company with concessions in the region is likely in the process of submitting field development plans in disputed areas, according to a person familiar with the situation.

"*In any frontier market, the majors taking a bigger position in production is viewed as a positive, as they have more capital to deploy and can develop the region,*" said a financial advisor who has worked on transactions in the region.

Political headwinds draw closer

While the fiscal situation improves, the region's already volatile political landscape is headed for a potential flashpoint: an independence referendum scheduled for 25 September. Polling from April indicates some 96% of Kurds favour independence, but the referendum has been criticised internally as a power play by President Barzani, who remains in power four years after the end of his term.

Externally, the move risks further complicating the KRG's fractious relationship with **Turkey**. The prospect of an independent Kurdish state on Turkey's border – and the increased calls to relinquish Kurdish majority territory in Turkey that may follow – is perceived as an existential threat in Ankara. Commentators have suggested that the referendum could provoke Turkey to close the pipeline to Ceyhan. Worse yet, it is suggested that the referendum could trigger civil conflict, with Iran and Turkey backing opposing sides.

All of the market participants interviewed for this report agree on the importance of the referendum, but opinions regarding the impact diverged from the positive – that it will further legitimise the region, emboldening IOCs to invest more – through to outright concern.

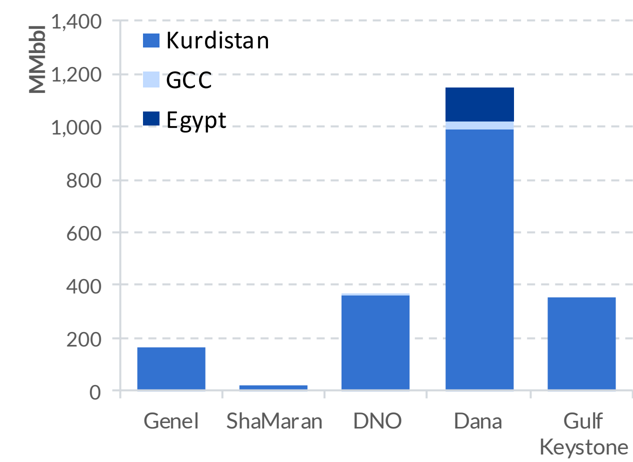
"*A lot will come down to the referendum – and how that plays out will be significantly driven by the media portrayal and public perception,*" said a portfolio manager.

DNO: Best of the bunch

Among the various bond issuers with operations in Kurdistan, Norway-headquartered DNO is generally seen as the strongest player, noted two portfolio managers and two credit analysts. The vast majority of its production derives from the Tawke license, in which it holds a 55% stake alongside Genel (25%) and the KRG (20%), and DNO is expected to commence production at the Peshkabir discover within the Tawke license later this year.

However, the company also plans to drill an appraisal and production well in its Erbil license, has limited production in Oman and, via the acquisition of Origo Exploration in May 2017, has claimed stakes in offshore licenses in Norway and the United Kingdom. "*Any kind of diversification is always going to be welcome,*" noted the first portfolio manager.

2P RESERVES (MMBBL) OF KRG-FOCUSED BOND ISSUERS



Source: Debtwire, company data

COMPANY LEVERAGE AND EBITDAX

Company	Total debt (USDm)	Net debt (USDm)	EBITDAX (USDm)	Total leverage	Net leverage
Dana Gas	779.0	481.0	190.0	4.10x	2.53x
DNO	364.5	1.6	126.7	2.88x	0.01x
Genel Energy[1]	648.2	241.2	130.7	4.96x	1.85x
Gulf Keystone[1]	98.9	6.0	108.3	0.91x	0.06x
ShaMaran	172.7	150.7	-3.8	-45.65x	-39.83x

Source: Debtwire calculations, company data
[1] Based on FY16 results

Unlike the Taq Taq field, reserve estimates for the Tawke license have not been significantly downgraded in recent years. Gross proven and probable reserves (2P) and contingent resources (2C) at Tawke stood at 604 million barrels (MMbbls) at end-2016, a reduction of 39.3 MMbbls from end-2015 as a result of oil being lifted.

A research note from *Exotix* published earlier this month assigned a buy rating to DNO's 8.75% 2020s, arguing that – as one of the first Western companies to enter Kurdistan – it secured slightly better contract terms with the KRG than other E&P companies. With comparatively low leverage and USD 362.9m in the bank as at March 30 2017, the company has proven something of an oasis in the desert for bond investors looking at Kurdistan.

Genel: Cooking with gas

By contrast, Genel has been hit by a succession of reserve downgrades at its Taq Taq license. The company has a 44% interest in the field via its partnership with Sinopec-subsidiary Addax in Taq Taq Operating Company (TTOPCO). Assessing Genel's future prospects is tricky, given that previous assumptions required multiple revisions, said the second portfolio manager and the first analyst.

In March 2017, Genel announced that gross implied 2P reserves at Taq Taq were 61 MMbbls at end-2016, down from 172MMbbls at end-2015 – which caused its London-listed shares to dip briefly from GBP 73p to an historic low of GBP 58.25p. Net 2P reserves attributable to Genel from all its assets have dipped from 429 MMbbls at end-2014 to 161 MMbbls at end-2016.

With the Taq Taq field near depleted, and a relatively small stake in the performing Tawke field, the company's main value proposition lies in its gas assets, said the two portfolio managers. Genel holds 100% working interests in the Miran and Bina Bawi gas fields.

"*The big question is, will gas start to play as meaningful a role in the region as oil has*," said the financial advisor. A [gas sales agreement]() between the KRG and Turkey was signed in 2013 to deliver gas from 2017, with Ankara hoping that Kurdistan may eventually supply sufficient amounts of gas to lower dependence on Russian and Iranian imports.

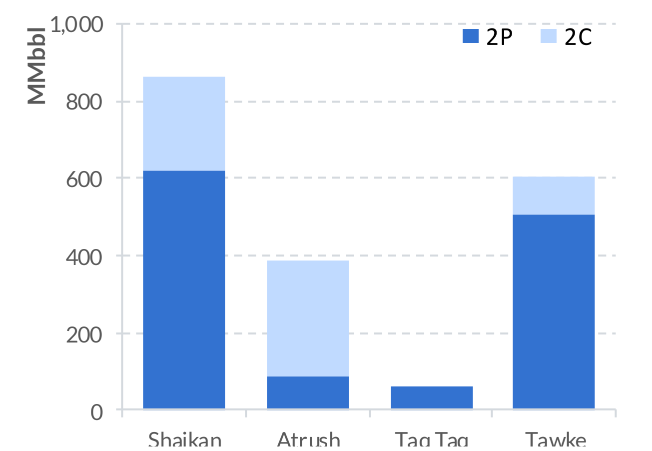
Genel is in ongoing discussions with wholly state-owned Turkey Energy Company (TEC) to partner on the projects, and an agreement could be announced in the coming months, according to a *Pareto* research note published in April.

As of end-2016, Genel's gas assets were assigned a carrying value of USD 867m. "*Even in a fire sale they could probably raise around USD 200m from these*," said the first analyst. The company now needs to meet a number of conditions precedent before the projects can proceed to development.

In April, Genel repurchased USD 252.8m of its May 2019 bonds at an average price of 85.56, with the notes indicated at 81 prior to the offer. Alongside increases in cash on the balance sheet, this has reduced net debt. With some USD 422m of the notes still outstanding, and – according to *RBC* calculations – potentially some USD 240m cash in hand at end-1H17, there would be scope for further buybacks.

However, Genel is, according to the *RBC* note, likely to spend its 2017-2018 cash on developing its assets, and as such "repayment ... of its bonds represents a challenge for management". Refinancing could prove tricky as a result of the depressed market conditions, and the company's best opportunity to raise funds may lie in its efforts to sell-down stakes in its Miran and Bina Bawi gas licenses, the note concludes.

2P & 2C REMAINING RESERVES (MMBBL) AT KEY LICENSES



Source: Debtwire, WesternZagros

ShaMaran: The undercover recovery

Slipping under the radar is **ShaMaran** – its USD 149m 11.5% November 2018 bonds are listed under the name of issuing vehicle General Exploration Partners – which is not yet a household name in the market. The company, which holds a 20.1% stake in the Atrush license alongside TAQA (39.9%), Marathon (15%) and the KRG (25%), announced in early-July that it had struck first oil [at the field]().

The development was seen as highly positive by the financial advisor, the second portfolio manager and a buysider. As cash flows improve, the price of the illiquid bonds will likely gradually trend upwards from the 70s level, said the portfolio manager and the buysider.

"*These bonds will go to par as soon as they start exporting the oil to show some cash-flow, but management will wait to refinance until around 4Q17 to 1Q18 when they have material cash-flows and are able to deleverage the balance sheet*," said the buysider.

The company could either take the bonds out with a private deal, possibly including some equity, or increase the size of the bond to USD 250m, if the company appraises the remainder of the field and show significant reserves, the buysider said.

In early May 2016, the Company completed a restructuring which provided it with USD 33m of additional liquidity via the issuance of USD 17m of new super-senior bonds, conversion of USD 18m of existing senior bonds into 218,863,000 ShaMaran common shares, and providing terms for the Company to pay future bond coupon interest in kind by issuing additional bonds.

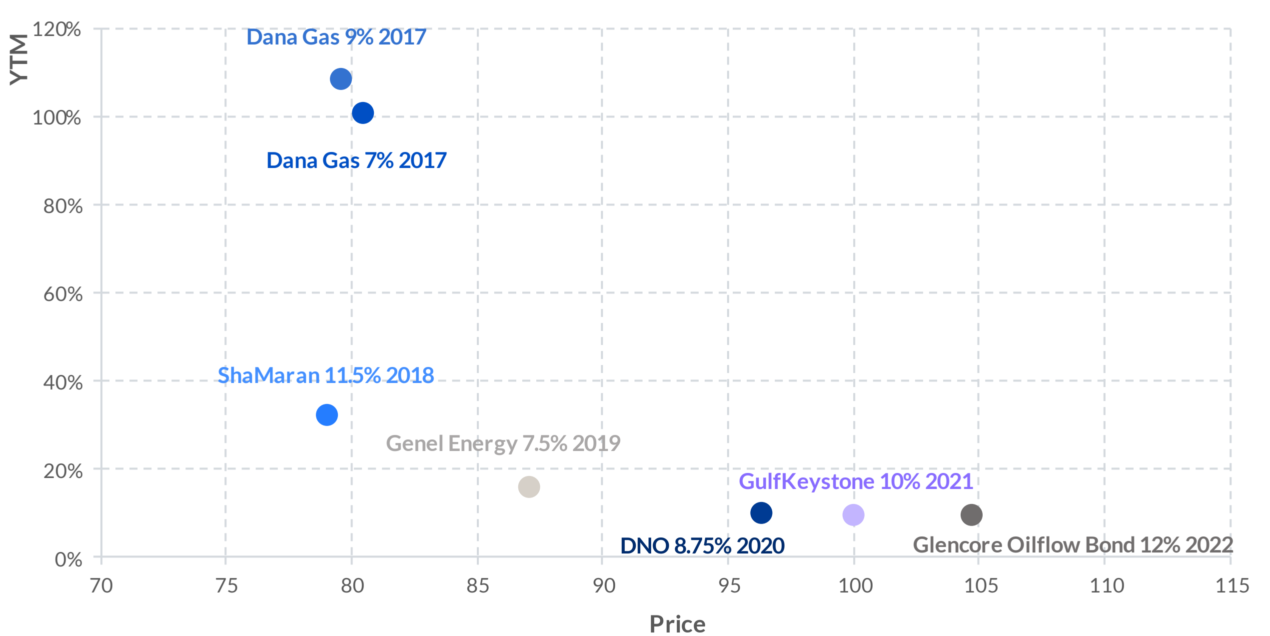
The 2016 restructuring was enacted to provide the company additional liquidity and offer breathing space while funding construction of a pipeline, which is now operational. Development at the field had dragged from an initial mid-2016 production date, and some in the market didn't think the company would cope due to the delays, said the buysider.

The Atrush field is seen as being of a high quality, said the second portfolio manager. While the reserves attributable to ShaMaran - some 17 MMbbls - are relatively small, they are enough to cover the company's debt burden, they said.

Oil started flowing through Atrush Central Processing facility on 3 July 2017, according to a recent company announcement. "Production is expected to ramp up in 2017 to the facilities design capacity of 30,000 barrels of oil equivalent per day."

Asked on its refinancing plans, company management told Debtwire that at this moment the company is looking at all opportunities. The 2018s were quoted at 71.25 a fortnight ago, and have risen to 79 yesterday, according to Markit data.

YIELDS/MATURITIES



Source: Debtwire, Markit

Dana Gas: See ya later, litigator!

Generating a lot of column inches lately for questioning the legality of its Islamic finance debt, Dana Gas is seeking to restructure its USD 350m 9% ordinary sukuk and its USD 340m 7% convertible sukuk. It is also embroiled in multiple arbitration proceedings against the KRG and Iran. It holds a 35% stake in Pearl Petroleum, which is developing the Khor Mor and Chemchemal gas fields.

Dana set forth a proposal to extend the sukuk by four-years and more than halve the profit-rate. Dana Gas claimed due to Shariah non-compliance, the outstanding notes are unenforceable – a move that has caused a storm in the Islamic Finance community. While the company improved EBITDA in 1Q17 to USD 69m, up 47% Year-on-Year, cash balances of USD 298m are insufficient to repay the notes at their October maturity and Dana Gas has not refinanced the notes.

Dana Gas is, unlike the other issuers in Kurdistan, diverse in its production – with average production of 40,950 barrels of oil equivalent per day (boepd) in Egypt and 26,500 boepd in Kurdistan in 1Q17. As with the other credits, payment collections have been erratic, not only in KRG but also in Egypt.

The company had, as of end-March 2017, overall trade receivables of USD 999m. However, while collections have been improving in Kurdistan since 2015, collections in Egypt have actually declined. At present, Dana Gas receives two monthly payments from the KRG: instalments toward a USD 100m pre-emptory arbitration award and another for monthly sales of LPG and condensate, according to a person familiar with the company.

The company is predominantly viewed as a litigation play, according to the first analyst and the second portfolio manager, with investors ultimately asking the question: can Dana recover the money from the KRG?

Pearl Petroleum has won a number of rulings at the London Court of International Arbitration (LCIA) relating to delays in field developments, and has been awarded more than USD 2bn, which the KRG continues to contest. A hearing in September at the LCIA will determine the final damages award, which Pearl claims could be as much as USD 26.5bn. Dana Gas is now seeking recognition and enforcement of the London award in the US.

The continued dispute is, according to the source familiar, a lose-lose situation. "*If they can settle the situation, the company can increase its production at Khor Mor and KRG can increase its electricity supply – which it urgently needs.*"

Gulf Keystone: Back in the swing of it

Having come to epitomise the risks of investing in Kurdistan when it went into restructuring last year, Gulf Keystone has stabilised performance and reduced debt to sustainable levels, according to the financial advisor. The reinstated 10% 2021s are indicated around par according to *Markit* data. The company started to struggle when it fell afoul of the KRG's late payments and ran into cash flow problems, said the advisor.

Despite this – and proving the adage '*once bitten, twice shy*' – the first portfolio manager said he no longer looked at the name: "*If I've got to play Russian roulette, I'd rather play with a revolver and not a semi-automatic pistol.*"

Under the terms of the restructuring, debt was reduced from more than USD 600m to USD 100m, with bondholders taking equity control of the company, securing 85.5% of the shares. The company also raised USD 25m in new money via an equity offer, giving a total enterprise value of USD 350m.

As of today, the shares are trading at GBP 90.44p, a market capitalisation of GBP 206.97m.

"*Gulf Keystone is now stable and generating cash flows*," the financial advisor said. However, the company has faced delays in deploying its cash for some time, the result of a renegotiation of its production sharing contract (PSC) with the KRG. Gulf Keystone previously guided that negotiations would be concluded by end-1H17, however this has now been pushed back.

Gross production at the Shaikan license, which Gulf Keystone has a 58% share, was 33,000 bbl/day in 2016. Guidance for 2017 lies between 32,000 to 37,000 bbl, with the lower end of this achievable without any additional wells being drilled, according to a *Pareto* research note published in March, with a planned expansion to 55,000 bbl/day expected to reach final investment decision (FID) when the PSC renegotiation is complete. The Shaikan field has not been subject to reserve revisions in recent years.

"*We continue to view M&A as the likely long-term solution to realize the full value potential of Shaikan*," the note continues, adding that small to medium-sized E&P companies do not generally hold a 58% stake in fields with resources a significant as Shaikan's.

By David Graves

and

Oliver Long

Contacts

CEEMEA Editorial	CEEMEA Research	Debtwire Commercial Sales	Relationship Management
Chris Haffenden, Managing Editor +44 (0)20 3741 1045, chris.haffenden@acuris.com	**Nicholas Smith-Saville,** Head of EMEA Research +44 (0)20 3741 1228, nicholas.smith-saville@acuris.com	**Jonathan Reed,** Managing Director +1 212 686 5418, jonathan.reed@acuris.com	**Victoria Moncrieff,** Manager, EMEA +44 (0)20 3741 1147, victoria.moncrieff@acuris.com
Alesia Sidliarevich, Assistant Editor, Restructuring +44 (0)20 3741 1048, alesia.sidliarevich@acuris.com	**Antigone Miltiadous,** Senior Analyst +612 9002 3124, antigone.miltiadous@acuris.com	**Angus Codd,** Head of Fixed Income Group Sales, EMEA +44 (0)20 3741 1002, angus.codd@acuris.com	**Jillian Maresco,** Manager, Americas +1 646 412 5306, jilian.maresco@acuris.com
John Foster, Africa Editor +44 (0)20 3741 1208, john.foster@acuris.com	**Elena Shutova,** Senior Analyst +44 (0)20 3741 1194, elena.shutova@acuris.com	**Jack Griffiths,** Account Manager, CEEMEA +44 (0)20 3741 1088, jack.griffiths@acuris.com	**Ging Wan, Manager,** Asia Pacific +852 2158 9739, ging.wan@acuris.com
Elias Lambrianos, Head of MENA +971 (0)52 926 572, elias.lambrianos@acuris.com	**Ignacio Cano,** Credit Analyst +44 20 3741 1433, ignacio.cano@acuris.com	**Jessie Ma,** Head of Sales, Asia +852 2158 9735, jessie.ma@acuris.com	
Michael Ogunleye, Reporter, Africa +44 (0)20 3741 1221, michael.ogunleye@acuris.com	**Jason Carey,** Research Editor +44 (0)20 3741 1049, jason.carey@acuris.com	**Lily Costa,** Emerging Markets Americas +1 646 378 3107, lily.costa@acuris.com	
David Graves, Senior Restructuring Reporter +44 (0)20 3741 1050, david.graves@acuris.com	**Shivangi Dattani,** Manager – EMEA Credit Research (Offshore) +91 (0)22 6235 1538, shivangi.dattani@acuris.com	**Jessica Monaco,** Emerging Markets Americas +1 212 686 5636, jessica.monaco@acuris.com	
Priscila Rocha, Reporter, Sovereign & DFI coverage +44 (0)20 3741 1206, priscila.rocha@acuris.com	**Darshan Bhanushali,** Credit Analyst +91 (0)22 6235 1542, darshan.bhanushali@acuris.com	**Adelene Lee,** Director, Subscriber-Content Relations +44 (0)20 3741 1321, adelene.lee@acuris.com	
Hassan Jivraj, Reporter, MENA +44 (0)20 3741 1061, hassan.jivraj@acuris.com	**Chirag Gangaramani,** Credit Analyst +91 (0)22 6235 1546, chirag.gangaramani@acuris.com		
Tomas Cutts, Reporter +44 (0)20 3741 1427, tomas.cutts@acuris.com	**Jason Whittard,** Credit Analyst +91 (0)22 6235 1761, jason.whittard@acuris.com		
Laura Gardner Cuesta, Reporter +44 (0)20 3741 1162, laura.gardner@acuris.com			
Dan Alderson, Loans Editor +44 (0)20 3741 1372, dan.alderson@acuris.com			

Debtwire is an Acuris company

Acuris

Debtwire reports on corporate debt situations before credit ratings are changed. Offering unique insights, credit analysis, debt data, and analytics for distressed debt and leveraged finance markets.

Subscribers choose *Debtwire* for speed and depth of coverage they can't get anywhere else. Our reporters talk to an impressive range of contacts every day to bring you valuable early insight into fast evolving situations.

To complement your newsfeed, *Debtwire*'s credit analysis and research teams provide deep technical details and angles that help you understand situations more clearly.

- Follow corporate debt situations as they unfold
- Find mandate opportunities in stressed/ distressed/restructuring situations, ahead of the market
- Get real-time news on market-moving events sent to your mobile or email
- Get the full story on restructurings and the players involved
- Understand how regulatory developments are affecting asset-backed securities
- Capture early stage primary opportunities and stay on top of the leveraged market

EMEA
10 Queen Street Place
London
EC4R 1BE
United Kingdom
+44 203 741 1000
sales@acuris.com

Americas
330 Hudson St.
4th Floor
New York,
NY 10013 USA
+1 212 500 7537
sales.us@acuris.com

Asia
Suite 1602-6
Grand Millennium Plaza
181 Queen's Road, Central
Hong Kong
+ 612 9002 3131
sales.asia@acuris.com

Disclaimer