



May 7, 2010

52-wk Range: £0.05-1.31  
12-month target: £2.00

Market Cap (M): £426.2  
EV (M): £426.2

## Oil & Gas

## Towards a resolution in Kurdistan?

### Summary

Gulf Keystone is an independent company whose objectives are to explore, develop and produce oil and gas primarily in North Africa and the Middle East.



### Key Metrics

Shares Outstanding (M): 494.5  
Current Price (GBP): £0.83

### Event

Middle East Online reported the Iraqi oil minister Hussein al-Shahristani saying that the Baghdad-Kurdistan oil row had ended with the Iraqi government agreeing to be responsible for paying extraction expenses in Kurdistan. All revenues would be handed over to SOMO, the Iraq's State Oil Marketing Organisation which deals with sales of crude and other petroleum-based products, and the Iraqi government will be responsible for paying the extraction expenses in Kurdistan.

Iraqi Kurdistan halted oil exports in October last year due to a payment dispute with Baghdad. The two sides previously clashed over how oil revenues should be distributed and Kurdish authorities had said they would not resume crude exports until Baghdad paid the foreign energy companies which are pumping the oil. The central government had repeatedly said it was opposed to the Kurds signing their own contracts, a position which Kurdish officials disregarded by making dozens of agreements with foreign firms

### Comment

All licences in Kurdistan are Production Sharing Contracts (PSCs) under which production is first used, up to a cap, to recover costs contracted by the operator in exploring and developing the field, this is called "cost oil". Subsequently any production or "profit oil" left is split between the contractor and the state. The dispute between the KRG and Baghdad is essentially about the details of the application of the oil sharing law as to whether cost and profit oil should be paid by Iraq out of gross revenues, i.e. revenue from all of Iraqi production, or should be paid by the regions out of net revenues, i.e. once revenues have been apportioned to the regions according to their population. Kurdistan argues the former and Bagdad the latter, despite our understanding that the interpretation of the law by the KRG seem to be the closest to the actual law.

Kurdistan having low production and 14% of the population, it is better for them to receive 14% of the net revenues, after cost and profit oil have been paid to contractors out of gross revenues, as it equates to a subsidy from the rest of Iraq towards exploration and development costs incurred in Kurdistan. Conversely as soon as the % of production from Kurdistan would be above their share of the population the opposite would be true, but may be by then most costs would have been recovered anyway.

This latest development vindicates the position of the KRG for cost oil but does not mention profit oil. I assume that this positive step announced today will be followed by a full resolution very soon.

For the operators, as long as the contracts are not renegotiated downward, it does not make a difference who pays them as long as they get paid for the oil produced. As I said, the latest news goes a long way towards a full resolution although understandably the market will remain somewhat cautious as long as some uncertainty remains. Obviously this is positive for all operators in Kurdistan with existing discoveries, such as Gulf Keystone, Heritage Oil and DNO.

### Recommendation

We retain our Buy recommendation on Gulf Keystone, with an unchanged target price of £2.00.

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### Lionel Therond

Lionel has worked at Fox-Davies since April 2009. Prior to this, he had 13 years experience as an investor at JPMorgan Asset Management and had previously spent 10 years in the Oil&Gas industry at Shell. Lionel graduated in Geology and Geophysics (MSc) before gaining an MBA at Insead; he is also a CFA charterholder.

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Research disclosure as of 07 May 2010

Company Name	Disclosure
Gulf Keystone	7

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Company	Ticker	Recommendation	Date	Target Price	Last Price
Oil & Gas					
Ascent Resources	AST LN Equity	BUY	22.04.10	£0.20	£0.04
Borders & Southern Petroleum	BOR LN Equity	BUY	01.02.10	£1.50	£0.54
Circle Oil	COP LN Equity	BUY	25.03.10	£0.85	£0.36
Desire Petroleum	DES LN Equity	HOLD	29.03.10	£1.00	£0.62
Enegi Oil	ENEG LN Equity	HOLD	17.12.09	£0.10	£0.14
Falklands Oil & Gas	FOGL LN Equity	BUY	01.02.10	£4.00	£1.57
Gulf Keystone	GKP LN Equity	BUY	07.05.10	£2.00	£0.83
Gulfsands Petroleum	GPX LN Equity	HOLD	04.05.10	£3.00	£2.82
Hardy Oil & Gas	HDY LN Equity	BUY	26.04.10	£3.00	£1.96
Matra Petroleum	MTA LN Equity	BUY	26.01.10	£0.11	£0.05
Max Petroleum	MXP LN Equity	BUY	24.03.10	£0.50	£0.18
Petrokamchatka	PKP CN Equity	HOLD	14.01.10	C\$0.15	C\$0.105
Po Valley	PVE AU Equity	BUY	29.04.10	A\$1.50	A\$0.33
Range Resources	RRL LN Equity	BUY	17.12.09	£0.08	£0.04
Rockhopper Exploration	RKH LN Equity	HOLD	07.05.10	£1.10	£0.94
San Leon Energy	SLE LN Equity	NA	NA	NA	£0.20
Sterling Energy	SEY LN Equity	HOLD	01.02.10	£1.50	£1.25
Tower Resources	TRP LN Equity	HOLD	23.03.10	£0.02	£0.01
Victoria Oil & Gas	VOG LN Equity	BUY	21.04.10	£0.09	£0.03

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