**Overview**

Gulf Keystone Ltd (GKP) was founded in 2001 by UAE, Kuwaiti and US private equity, and is incorporated in Bermuda. In 2004 it was admitted on to AIM raising £60.0m at 48.0 pence per share providing capital for further exploration in Algeria. In 2007 GKP signed a production sharing contract with the Kurdistan regional government to explore and develop the Shaikan oil field in Northern Iraq. Through its subsidiary, Gulf Keystone Petroleum International, the company owns production sharing contracts for four exploration blocks in Iraqi Kurdistan that include Shaikan, Sheikh Adi, Ber Bahr and Akri-Bijeel, with a total area under license of 1,624km2. The company has branch offices in [Arbil](http://en.wikipedia.org/wiki/Arbil), Kurdistan, [Algiers](http://en.wikipedia.org/wiki/Algiers), Algeria, and London.

**Shaikan Block - a huge commercial success from exploration to production in Kurdistan**

* In 2007 GKP in partnership with Kalegran Ltd, a subsidiary of MOL Hungarian Oil and Gas Public Limited Company (MOL) and Texas Keystone Inc, signed a production sharing contract with the Kurdistan Regional Government (KRG), for the exploration, development and production of hydrocarbon resources in the Shaikan Block in the Dihok area of the Kurdistan Region of Northern Iraq. Under the partnership GKP holds 75%, Kalegran 20% and Texas Keystone 5% of the Shaikan Block. In consideration for introducing Kalegran into the Shaikan partnership, GKP received a 20% interest in the Akri-Bijeel Block adjacent to Shaikan.
* During 2008 and 2009 GKP carried out extensive 2D seismic explorations and started drilling wells on the Shaikan Block. In the second half of 2009 GKP announced a huge oil discovery in the Shaikan-1 exploration well, which was estimated to have the production potential of 1bn to 5.8bn barrels of oil. To further strengthen its position in Kurdistan, GKP acquired two production sharing contracts for the exploration, development and production of hydrocarbon resources in the Sheikh Adi and Ber Bahr Blocks of the Kurdistan Region of Northern Iraq. In Sheikh Adi GKP holds an 80% interest while in the Ber Bahr Block it holds a 40% interest. Meanwhile the company decided to exit from Algeria and focus its resources on Kurdistan operations.
* In the preceding three and half years following the first discovery of Shaikan-1, GKP acquired 3D seismic data of the Shaikan Block. Further drilling increased its audited gross oil-in-place from 1bn to 5.8bn barrels of oil to 8bn to 13.4bn barrels of oil calculated on the P90 to P10 basis respectively with a mean value of 10.5bn barrels. In 2012 Shaikan was declared a commercial discovery. In January 2013 Gulf Keystone submitted a Field Development Plan (FDP) to the Shaikan Block Management Committee which was passed in June.
* In the first six months of 2013 the Shaikan field produced an aggregate of 183,000 barrels of oil, of which 179,063 barrels were sold into the domestic market. By early January 2014, average oil sales from first production facility (PF-1) stand at between 9,000 and 10,000bopd, with the potential increase of 20,000 bopd. The group is constructing a second production facility (PF-2) which will be capable of producing 20,000 bopd, lifting total output to around 40,000 bopd. GKP hope this will be completed in early 2014 and will increase to 150,000 bopd within three years and 250,000 bopd by 2018.
* In addition to the Shaikan discovery, GKP found success in all its remaining blocks of Akri Bijlee, Sheikh Adi and Ber Bahr. In the last four years GKP has drilled 18 wells for the exploration in the Kurdistan region of Iraq with oil found in all wells de-risking 19bn barrels of oil in its share.
* GKP exported crude to international markets from the Shaikan field in December. GKP tendered its first cargo of Shaikan crude, between 198,300 and 215,000 barrels of oil, to Turkey by truck and will be loading at the port of Dortyol by the end of January 2014. The company further added that a second tender is under way for two further cargoes of similar size of Shaikan crude, which are expected to be loaded later in January and during February. Sales realisations are expected to be in accordance with the terms of the production sharing contract for the Shaikan Block and will reflect transportation and quality adjustments.

# Gulf Keystone wins key court Judgement against Excalibur

In 2010 Excalibur sued GKP at the Commercial Court in London over Kurdistan’s Shaikan oil field. It claimed Rex Wempen, owner of Excalibur, had introduced Todd Kozel, CEO of GKP, to opportunities in Iraq’s Kurdistan region in 2005, and used his contacts to help win oil-exploration rights from the government. Wempen said a collaboration agreement signed by Kozel’s Texas Keystone Inc gives Wempen a 30% share of the Shaikan concession and Gulf Keystone was an agent of Texas Keystone.

GKP defended its position saying the Wempen brothers’ company was excluded from participating in production-sharing agreements by the Kurdistan Regional government because of the oil ministry’s concerns about Excalibur’s technical capacity to develop the field. It also [argues Excalibur exaggerated its ability to fund the project](http://www.ft.com/cms/s/0/349c9cd2-1945-11e2-af4e-00144feabdc0.html). GKP said it gave Excalibur the opportunity to participate after November 2007, but it could not raise the money for a signing bonus.

The pre-trial proceedings began in October 2012 and were completed on 1 March 2013. In March, the court ordered Excalibur to pay £6m as security towards Gulf Keystone’s costs and £3.5m towards Texas Keystone ahead of the trial.

In a judgement in September 2013, the court rejected claims made by Excalibur Ventures that it was entitled to a 30% share in the company's oil fields. They said that the collaboration agreement does not create, give rise to or recognise any entitlement of Excalibur to an indirect interest in the Shaikan Block or any other production sharing contract. The hearing was adjourned, to a date to be fixed, for arguments on costs and any application for permission to appeal.

In a final decision on 13th December 2013, after Excalibur Ventures decided not to launch an appeal against a Commercial Court judgment made in September, the court ordered Excalibur to pay £17.5m of the defendants cost, of which GKP and its subsidiaries will receive £10.7m and Texas Keystone will receive £6.8m. The cash had been paid by Excalibur to the court as security for the defendants' costs. Additional security for GKP and its subsidiaries of £3.2m has been ordered by the court as well as an additional £2.4m for Texas Keystone.

**Full listing plans**

In May 2013 GKP updated the market saying it intended to move from AIM to a full listing on the London Stock Exchange, splitting the roles of the chairman and chief executive in anticipation. The company achieved a coup by appointing Simon Murray, former chairman of Glencore, as chairman and head of the remuneration committee. The company also appointed four new independent directors to its board, as proposed by its largest shareholders M&G and Capital Group. In September after winning the court case against Excalibur, GKP appointed Deutsche Bank to act on an exclusive basis in connection with the proposed move from AIM, to the Standard Segment of the London Stock Exchange. In a recent update, GKP said that it is in advanced stages of finalising the relevant documents including the Listing Prospectus, the Competent Person's Report and the required financial reports. GKP is looking for full listing as soon as practicable in 2014.

**City view on the stock**

Analysts at Goldman Sachs upgraded Gulf Keystone Petroleum to ‘buy’ from ‘neutral’ and increased their target to 283.0p per share from 265.0p. The bank say Gulf Keystone shares have been weak despite the positive announcement of the Excalibur litigation update. The bank adds that the current share price does not reflect any value for Merger & Acquisitions potential, despite Gulf Keystone's attractive exposure to this theme.

HSBC upgraded GKP to ‘overweight’ from ‘underweight’ with the same price target of 185.0p, after it won the Excalibur case.

Westhouse Securities has upgraded GKP to ‘neutral’ from ‘sell’ with a 160.0p target.

#### Broker Forecasts’ three-month consensus data show that 50% of brokers continue to rate the shares as ‘overweight’ or 'buy' while 50% rate them as a 'neutral'.

**What next for Gulf Keystone Shareholders?**

In a half year result announced in September Gulf Keystone further reiterated its cash-neutral approach to growing operations, including drilling up to eight wells on Shaikan in 2014 and investment decisions on additional Shaikan production facilities. The group's cash and cash equivalents at 16 September were $101.2m. Losses for the period narrowed to $26.4m compared with a $31.4m loss a year earlier, although there were no revenues during the period.

In October, GKP issued £50.0m convertible bonds to boost its cash position sufficiently to complete its transition towards a short-term production target of 40,000 bopd. GKP further added that it is looking to achieve stable oil production and sales from PF-1 and PF-2 in 2014. After this it will look for long-term debt funding needed for the large-scale development planned for the Shaikan field. They will be able to access debt market under more favourable terms on recurring revenue from oil sale, which envisages achieving phase one production of 100,000 bopd, and will require drilling on an additional 19 wells and construction of at least two additional production facilities. The company continues to pursue the sale of 20% working interest in the Akri-Bijeel project.

According to the Kurdistan Regional Government, Kurdistan has 45bn of barrels of oil and GKP’s share of the oil in the country is about 19bn barrels; making it Kurdistan’s biggest independent oil company. In a short period of just over three years between the Shaikan-1 discovery in 2009 and the approval of Shaikan Field Development Plan in June 2013, GKP has transformed itself from an exploration company to a production company.

Following the approval of the Shaikan FDP, Gulf Keystone has already completed and commissioned PF-1, which is producing oil between 9,000 and 10,000bopd which will increase to 20,000 bopd. When combined with PF-2, which is to complete by early 2014, the company will achieve its immediate short-term production target of 40,000 bopd. As noted, this will increase to 150,000 bopd within three years and 250,000 bopd by 2018.

The Shaikan field still has further oil-in-place and a mean value of 13.7bn barrels of gross oil will be revised significantly when Shaikan 7, the company's first deep exploration well, becomes available. Shaikan 7, which GKP started drilling in June 2013, in proximity of the producing wells Shaikan 1 and 3, will explore the mid to lower Triassic, and potentially the Permian, horizons of the Shaikan structure. Potential additional oil volumes exist in the Cretaceous formation to the north of the field, which the company has not yet accounted for.

In addition to Shaikan, GKP made two further discoveries in the last 12 months: a Jurassic discovery on the company-operated Sheikh Adi Block and a new Triassic discovery on the Akri-Bijeel Block operated by Kalegran. In November, Akri-Bijeel block was declared commercial. Kalegran is accelerating its work program through employing additional rigs and plans to submit the Field Development Plan for the whole block by the end of 2014. The Bijeel Field facility is capable of handling up to 10,000 barrels of oil per day. The Sheikh Adi Block located next to the Shaikan Block has a well-developed system of natural fractures similar to Shaikan. GKP initially estimated gross oil-in-place in a range of between 1bn to 3bn barrels of oil which will be revised on exploration.

One of the biggest problems GKP faced since its existence in Kurdistan is a ban on oil exports caused by dispute on oil sharing revenue between the Kurdistan Regional Government and Iraq's Central Government. Kurdistan is resolving this issue by developing a new pipeline with initial capacity of 300,000 bopd. The pipeline is completed and oil from Kurdistan has started flowing via a new pipeline to the Turkish Mediterranean export hub of Ceyhan but cannot be shipped to the world markets without the consent of Iraqi government. Turkey has been working to get the Iraq central government on board before exports start. By 2015 the pipeline capacity will increase to 1m bopd.

GKP exported its first cargo of Shaikan crude, between 198,300 and 215,000 barrels of oil, via Turkey in December and will export two more cargoes of similar quantity in January and February. This is symbolic, as it has passed its biggest hurdle of exports despite Kurdistan and Iraq disputing on oil sharing revenue. GKP is exporting via truck while its 10km Shaikan pipeline is constructed. This will eventually connect Shaikan to the export pipeline to Turkey.

GKP has resolved the shareholder revolt concerning poor corporate governance and excessive executive pay by appointing four new non-executive directors proposed by shareholders in the AGM. This has removed uncertainty regarding GKP’s corporate governance suggesting it is serious about developing the Kurdistan portfolio and listing on FTSE 100/250.

There was speculation in April 2013 that the court case against GKP was a done deal when CEO Kozel cut his shareholding by more than 40%, transferring 10 million of his 24 million shares to an unnamed third party, in settlement of a financing arrangement. This leaves him with almost 14 million in stock options and a paltry 255,004 shares held directly. Although not confirmed by the company the share transfer could be a part of divorce settlement agreed last year by Kozel to transfer 17 million of his shares to his ex-wife. The timing of the announcement has created uncertainty for the GKP share price.

GulfKeystone has already won a court case against Excalibur Ventures. Excalibur who were backed by US litigation financiers Blackrobe, US hedge fund Hamilton and Psar will also pay Gulfkeystone £13.9m defendant costs. Judgement in favour removed a legal shadow hanging over the company from the last three years; clearing the path for listing in the main market in 2014 and making it more attractive for potential suitors.

Apart from all the negative news garnered by GKP in last three years, it has attractive growth potential with a share of 19bn barrels of oil-in-place with further potential upside on the Shaikan and Sheikh-Adi Blocks. The oil can be extracted relatively cheaply and is of good quality. The Kurdistan oil pipeline has already been completed but still no agreement has been reached between Iraq and Kurdistan over oil exports and revenue sharing. Any agreement on oil export will remove any uncertainty of generating revenue by oil exports, paving the way for self-sustainability and raising long-term debt financing for exploration and production.

GKP has resolved three major disputes in the last six months; the shareholder revolt, the court case against Excalibur Ventures and now the first export of oil through Turkey. All of these were having a negative effect on share prices. Share prices are still trading below 200.0p, even after the favourable court case results, indicating the market is still uncertain on GKP underperformance of PF-1, oil exports dispute between Kurdistan and Iraq and how much long-term debt financing it will require for first production phase.

Any good news on the Kurdistan and Iraq agreement on oil export, or Shaikan field production and exploration result will move share prices up. The GKP share price looks attractive and could go sky high if rumours of an ‘offer of acquisition’ comes from big companies like Exxon, Chevron or Total. Finally, when the company is fully listed on the premium market of the London Stock Exchange, tracker funds will buy shares thereby increasing the company’s value.

|  |  |
| --- | --- |
| Share price (pence) | 190.0 |
| Year High/ Low (pence) | 245.0/126.31 |
| Market Cap (£bn) | 1.66 |
| Average daily Volume (mn) | 3.42 |
| P/E (TTM) | - |
| Sector P/E (TTM) | 13.7 |
| Fiscal Year | 31 December 2012 |

