REPORT

# Foreign Commercial Activity in Iraq
## 2010 Year in Review

Dunia Frontier Consultants
Washington, DC | Dubai | Kampala
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## Executive Summary: Maturing Marketplace Sees Greater Deal Flow

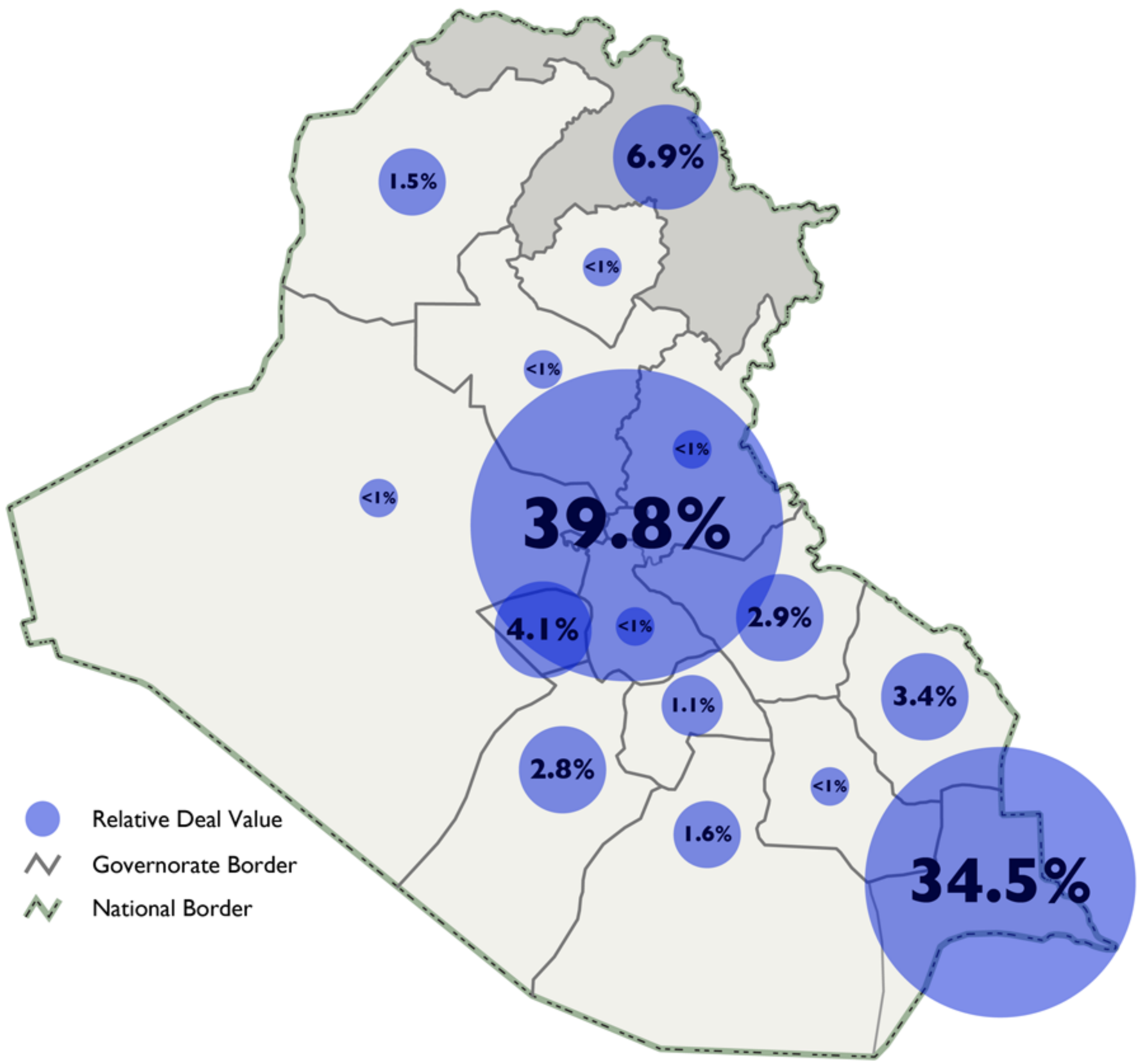


Figure 1. Relative Size and Geographic Distribution of Foreign Commercial Activity

**In 2010, foreign firms and investors reported $42.668 billion in investments, service contracts and other commercial activities across Iraq — an estimated 48.7 percent increase in total deal value over the previous year.** This continued double-digit growth in deal flow occurred despite more than nine months of political uncertainty and heightened violence following the March national elections. At the same time, 2010 saw far fewer announcements of the overly ambitious, multi-billion dollar investment deals that had captured headlines in previous years but often failed to materialize. Instead, higher volume and smaller average deal size reflected a growing maturity of the Iraqi economy as a place for regional and international firms to do business.

Several major conclusions emerged from Dunia's analysis:

- The total number of reported investments, service contracts and other commercial activities by foreign firms in Iraq more than doubled over the previous year, increasing 190 percent to 164.
- Average deal size fell from $683 million to $260 million, reflecting the proliferation of smaller-scale but more realistic deals that are actually being implemented on the ground.
- 2010 saw sizeable increases in foreign commercial activity in the relatively secure southern governorates. This trend was particularly evident when looking at deals valued at under $1 billion, with governorates like Karbala, Wassit, Maysan and Najaf *each* attracting levels of foreign commercial activity as high as those in the Kurdish region.
- Turkish firms clearly dominate the geographic rankings of foreign commercial activity, while countries like France and the United States superseded other regional countries that have until now also played a dominant role in Iraq's economy.
- The development of Iraq's hydrocarbon industry is well underway, with more deals announced in oil and gas than in any other sector during 2010; however, these deals tended to be valued at between $100 – $300 million, so the sector generally lagged in absolute terms behind other sectors.
- The top sector was residential real estate, which accounted for 33% of all reported for foreign commercial activity in Iraq during 2010. The other tops sectors were transportation infrastructure (including sea, air, roads and rail), electricity and industry (particularly materials like cement and steel), and oil and gas production.

The data presented in this report are not intended to be exhaustive, but instead to reflect emerging trends and to provide useful insights into how the Iraqi economy is evolving. While the protracted political quarreling of 2010 exposed lingering sectarian divides and tensions in Iraqi society, the return of Prime Minister Nouri al-Maliki for a second term, along with a fairly familiar ruling coalition, offers foreign firms and investors a sense of continuity and the hope that economic development in Iraq will continue unabated. If current trends continue, 2011 will be the first year for Iraq without major violence and without the distractions of political upheaval. Dunia expects to see continued strong growth in foreign commercial activity across all sectors in Iraq. Although significant challenges to the country's economic development remain, 2010 proved beyond doubt that Iraq is a rapidly emerging market with enormous potential.

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***NOTE**: This is the latest report by Dunia Frontier Consultants to track the activities of foreign firms and investors in Iraq. It follows similar surveys conducted in 2009 and 2010, but employs a different methodology[1] that has been developed in response to particular market developments in Iraq and changes in the behavior of foreign firms. In response to a surge in commercial activity beyond foreign investment, as well as the increasing complexity of cross-border capital flows into Iraq, Dunia has broadened the scope of its data collection (now employing the category "foreign commercial activity") while simultaneously adopting more stringent criteria for reporting individual deals. Dunia has also retroactively applied these new criteria to its data from prior years, in order to develop a more accurate model of annual changes in foreign business activity in Iraq since 2003.*

[1] See Appendix 1: Note on Methodology

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## I. Introduction: Despite Year of Uncertainty, Foreign Firms Embraced Iraq

Iraq faced a tumultuous 2010 in both political and economic terms. Despite repeated delays, Iraq on March 7 concluded its second national election since 2003, which after more than nine subsequent months of legal disputes and fractious coalition building saw Prime Minister Nouri al-Maliki return for a second term. This period of intense post-election quarreling also coincided with a return of the some of the worst violence in Iraq since August 2009 (see Fig. 3 below).

On the economic front, oil field development kicked off in earnest, with international oil companies (IOCs) dedicating billions of dollars to revitalize Iraq's moribund hydrocarbon sector. Additionally, Iraq concluded its third petroleum licensing round, auctioning off three major natural gas fields to international companies in October. Across all sectors, foreign firms continued to announce new projects and contracts. The Iraq Stock Exchange (ISX), which held 237 trading sessions and recorded nearly $340 million in trade volume in 2010, has now attracted the attention of a number of foreign private equity and hedge funds that are actively raising capital for index investing.

The total number of reported investments, service contracts and other commercial activities by foreign firms in Iraq more than doubled over the previous year, increasing 190 percent in 2010 to 164. At the same time, average deal size fell from $683 million to $320 million, reflecting the proliferation of smaller-scale but more concrete deals that are being implemented on the ground. This is an especially welcome contrast to the dominant trend of 2008 – 2009, during which numerous multi-billion dollar investments rarely materialized following their announcement.[2]

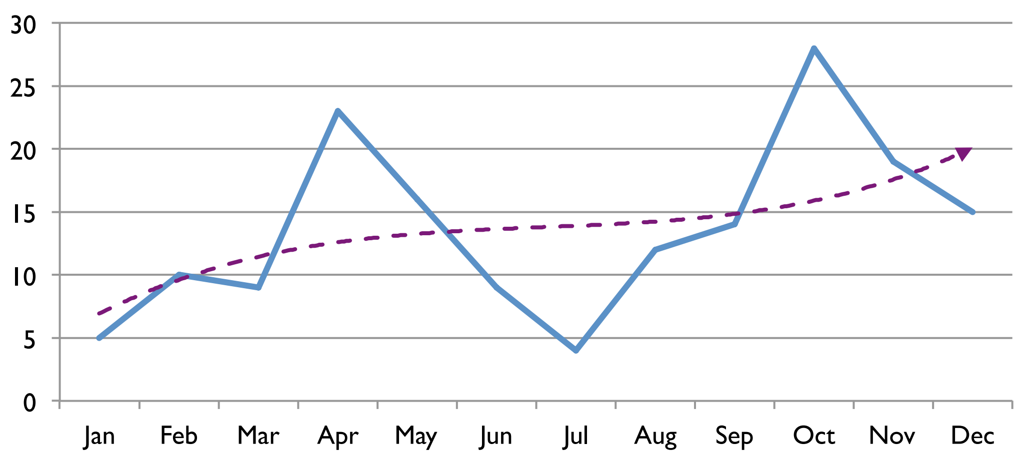


**Figure 2. Monthly Deal Flow (and Trendline) in 2010**

The uncertainty following the March elections, coupled with a rise of violence that peaked in mid-summer, had a noticeable effect on the pace of deal flow (see Fig. 2 above). At the same time,

[2] Prime examples of this include the $15 billion Tarin Hills mixed-use real estate project in Iraqi Kurdistan by Dubai-based developer Damac Properties, which was announced in 2008 and officially cancelled in mid-2010; a $20 billion industrial city proposal by a South Korean consortium for Anbar governorate's Lake Habaniyah announced in 2009; and a similar $8 billion proposal by a Turkish company to construct an industrial city complex near Nasiriyah in Dhi Qar governorate.

however, there were discernable peaks in activity that coincided with the elections in March, as well as the return of relative stability with *Eid-al-Fitr* and the first signs of a political compromise in early autumn. This underscores how carefully most foreign firms are still watching political and security developments in Iraq. While the contentious and largely sectarian nature of the post-election period gave pause to many foreign observers, the return of Prime Minister Maliki at the head of a fairly similar ruling coalition seems to have reassured foreign firms that there will be sufficient political and legal continuity in the years ahead. In particular, the retention by Maliki's State of Law coalition of the Ministry of Oil portfolio[3] was welcome news not only to IOCs and oil service companies (OSCs), but also to other foreign firms who are counting on revenue from Iraqi oil exports to fuel future government expenditure and economic growth.

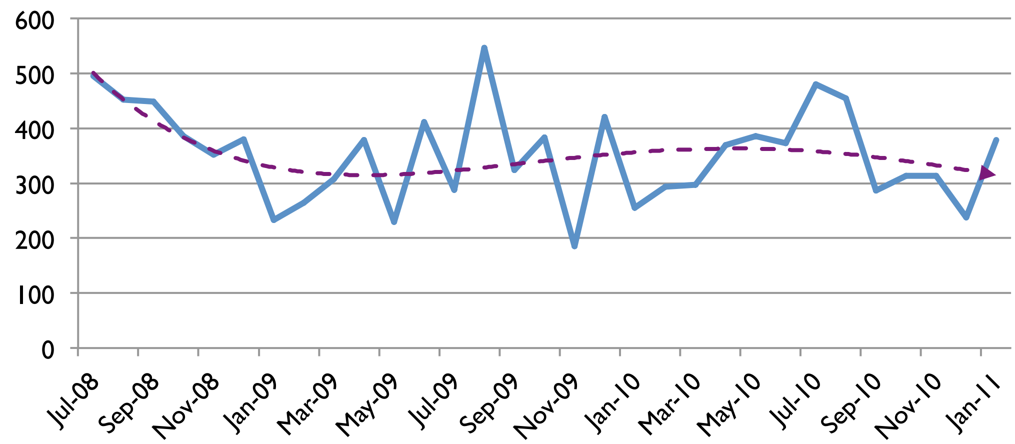


**Figure 3. Monthly Fatalities in Iraq (and Trendline), July 2008 – December 2010)**

The security environment in Iraq did experience a clear deterioration during the summer of 2010. Several coordinated bombing campaigns against central and southern governorates occurred between late March and mid-September, which drove up the average number of fatalities to levels not seen since major sectarian violence ended in 2008. However, the violence was clearly tied to the overall political uncertainty facing the country, and it fell sharply once political compromise had been reached at year's end. Somewhat peculiarly, many foreign firms and investors viewed the highly targeted and political nature of the violence as a confirmation that the operating environment in Iraq continues to improve.

The improved security trend across Iraq was also reflected in the data concerning deal announcements. Baghdad and Basra commanded the vast majority of capital flows (around 74 percent), and the semi-autonomous Kurdish areas of Iraq (the governorates of Dahuk, Erbil and Sulaymaniyah) continued to attract strong foreign interest thanks to the virtual absence of security incidents. However, there were sizeable increases in foreign commercial activity in governorates like Wassit, Najaf and Maysan where security has also generally been good. This trend is even

[3] Former Oil Minister Hussein al-Shahristani, who was instrumental in organizing the first three petroleum licensing rounds and persuading IOCs to accept relatively low per barrel service fees as part of the technical service agreements to develop Iraq's oil and gas fields, has been elevated to the position of Deputy Prime Minister for Energy. His former deputy, Abdul Karim al-Luaibi, has now taken over as Minister of Oil, although Shahristani remains intimately involved with the goings-on at the ministry.

more evident in deals valued at under $1 billion, with governorates like Karbala, Wassit, Maysan and Najaf *each* attracting similar levels of foreign commercial activity as the Kurdish region of Iraq.

With a new government in place, the security outlook is expected to remain relatively positive through 2011, particularly for foreign business interests in Iraq. The threat of targeted political violence will continue into the indefinite future, along with occasional increases in sectarian violence that coincide with religious holidays. The major challenges to this security assessment are mostly political. Prime Minister Maliki has yet to appoint new heads to four key ministries: defense and interior, which together control the Iraqi security forces, as well as the national security and intelligence ministries. Continued quarrelling or controversial choices risk reigniting factional violence. The future of Kirkuk and its oil resources, as well as the lingering uncertainty over oil revenue sharing between the Kurdish region and rest of Iraq, continue to be the largest political challenges, and have the greatest potential to disrupt progress in Iraq.

At the end of 2010, IOCs operating the four largest oil fields auctioned in 2009 (Rumaila, West Qurna 1, Majnoon and Zubair) all reported achieving 10 percent increases in production, which allows for cost recovery. At Rumaila, which was the first field to begin redevelopment, BP and CNPC boosted output 17 percent to 1.25 million barrels per day (bpd) in 2010, already exceeding production targets set for mid-2011. Emboldened by this success, the Iraqi government is reportedly moving forward with a fourth petroleum licensing round to be held in the fourth quarter of 2011 that will include both oil and gas deposits. The oil ministry has suggested that 12 exploration blocks are being considered for the auction, and that it hopes to attract more than the 45 companies that were pre-qualified for previous bidding rounds. Although still in the planning stages, the fourth round is expected to include resources in relatively unexplored governorates such as Karbala, Najaf, Muthanna and Anbar.

In March 2011, Iraq is slated to host the annual Arab League summit for the first time in 20 years, an event which is being hailed domestically as a symbol of the country's improved security and increased integration into the regional economy. Iraq is eager to convey an image of recovery and stability that can accelerate the process of reconstruction. Cross-border trade with Turkey and Iran is rapidly accelerating, reaching an estimated $6 billion and $4 billion in 2010 respectively, with Iraq's neighbors projecting increases in trade volume of 150 – 400 percent over the next five years. The National Investment Commission continues its calls for hundreds of billions of dollars in foreign investment across all sectors of Iraq's economy, including the construction of between 2 million to 3 million homes, and joint ventures or production-sharing agreements with state-owned enterprises (a model which successfully attracted foreign private equity in 2010, but which had not done so previously).

Without a doubt, unprecedented numbers of foreign firms and investors entered Iraq and announced new deals in 2010, but with political uncertainty fading, 2011 is expected to see even greater capital inflows and commercial activity.

## II. By the Numbers: The Big Picture

During 2010, 156 foreign firms from 34 different countries announced new investments, service contracts and other commercial activities in Iraq. The total reported value of these deals reached $42.668 billion.[4]

| Table 1. Geographic Distribution and Value of Foreign Commercial Activity in Iraq[5] | | |
|---|---|---|
| *Country* | *$ (millions)* | *% Total* |
| Turkey | 14,883 | 34.9% |
| Italy | 5,292 | 12.4% |
| France | 4,243 | 9.9% |
| South Korea | 3,269 | 7.7% |
| USA | 1,997 | 4.7% |
| China | 1,736 | 4.1% |
| UAE | 1,318 | 3.1% |
| Canada | 1,247 | 2.9% |
| UK | 1,215 | 2.8% |
| Australia | 883 | 2.1% |
| Russia | 752 | 1.8% |
| Jordan | 669 | 1.6% |

2010 bore witness to a major shift in the geographic origin of foreign commercial activity in Iraq: Turkish firms dominated the scene, announcing 22 deals in governorates across Iraq, and catapulting ahead of regional players such as the UAE, Jordan and Lebanon, which had previously dominated such rankings.

Indeed, the sharp decline in standing of the UAE in particular (whose investors had captured headlines in previous years with announcements of multi-billion dollar "mega" real estate deals) is due not simply to the economic effects of the credit crisis that humbled Dubai beginning in late 2009, but also underscores the theme of Iraq as a maturing marketplace for foreign companies. Put simply, Turkish firms up to this point have generally engaged in relatively small ($100 - $300 million) deals, and 2010 was the year in which the pace of such deals finally eclipsed the mega deals of the last few years. While Turkish firms also succeeded in capturing a piece of the largest announced real estate deal of 2010, the country's top-ranking also holds true for deals valued at under $1 billion (see below).

The presence of Italy and South Korea at the top of the list are, however, due exclusively to multi-billion dollar deals. In the case of Italy, a consortium of Italian firms led by Technital S.p.A. signed a

[4] See Appendix 1: Note on Methodology for an explanation of calculating total deal volume.
[5] Other significant countries, but with less than 1 percent of reported deal volume: Iran, Egypt, UK, Saudi Arabia, Kuwait, Lebanon, Belgium, Luxembourg, Sweden, Germany, and Spain.

contract in April 2010 to build a massive new port in al-Faw, Basra. The $4.6 billion project will be the largest infrastructure project in Iraq in decades, and the Iraqi Ministry of Transportation claims the new port will have a capacity of 99 million tons per year. At the same time, however, Italian firms also announced significant contracts and investments in the real estate, energy and industrial sectors. In the case of South Korea, STX Heavy Industries in late December 2010 signed a $3 billion engineering, procurement and construction deal with the Ministry of Industry to rehabilitate a petrochemical (plastics) factory in Basra. STX Heavy Industries confirmed the deal, although a similar multi-billion dollar proposal in January to revitalize the Basra Iron and Steel Factory apparently stalled after negotiations failed with the state-owned company's labor union.

Another new entrant among the top five which certainly deserves its place is France. Former French ambassador to Iraq Boris Bouillon was particularly aggressive (and successful) in encouraging his countrymen to pursue lucrative contracts and to invest. While blue-chip French companies like Areva, Schneider Electric, Alstom, Systra, Suez Environnement and Lafarge all secured high-profile contracts with the Iraqi government in 2010, other French firms and smaller businesses have been aggressively pursuing investment opportunities, and the French government has been opening consulates and business centers across Iraq (in Baghdad, Basra, Erbil and Nasiriyah — with plans to expand to Anbar and Wassit) to assist them.

Finally, as with previous years, the strong showing of the United States is due in large part to its participation in Iraq's oil and gas sector. However, while US-based IOCs and oil services companies (OSCs) form a central component of Iraq's resurgent hydrocarbon industry, 2010 also saw the entrance to Iraq of a number of US firms in sectors such as finance, real estate, hospitality, transportation and agriculture. It is estimated that the value of this non-energy-related commercial activity is around $720 million, which while a significant increase over 2009 is still less than 1.7 percent of total foreign commercial activity.

## Major Real Estate Deals Still Dominate Iraq's Economy

Despite the rapid development of oil fields by IOCs in southern Iraq, capital outlays proved to be more muted in 2010 than anticipated. Although millions of dollars in drilling, service and construction contracts were awarded to firms like Halliburton, Weatherford, Baker Hughes, Schlumberger, WorleyParsons, Petrofac and China's Daqing Oil Field Co.,[6] the largest reported deal in the sector was the October 2010 award to Australia's Leighton Offshore Private Ltd. of a $733 million contract to build a new floating oil export terminal in Basra.

Compared to the large number of reported oil and gas deals (28, more than any other sector), residential real estate enjoyed the largest share of foreign commercial activity (see Table 2 below) thanks to the announcement in early December 2010 of an $11.28 billion project to help rebuild Baghdad's Sadr City neighborhood awarded to a consortium of Turkish contractors. The four-year project is expected to see 75,000 new homes built, in addition to other recreational facilities, mosques, and schools.

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[6] The exact value of many of these oil sector deals often goes unreported, making a fair estimate of sector size more difficult. See Appendix I: Note on Methodology for a discussion of unreported deal value.

  

While the most significant study to date[7] of Iraq's existing housing stock estimated a total national housing deficit of 1.6 million units, the Iraqi National Investment Commission and the Ministry of Planning issued a call in late 2010 for some 3.5 million housing units to be built by 2020 at an estimated cost of US$25 billion. The National Investment Commission expects at least 85 percent of that construction will be carried out by the private sector. Given the magnitude of these critical housing shortages, the sector will continue to be a primary focus of foreign commercial activity over the next decade. It will also continue to be one of the most political (and therefore most difficult) to accurately assess.

Table 2. Sector Breakdown of Foreign Commercial Activity

| *Sector* | *$ (millions)* | *% Total* |
|---|---|---|
| Real Estate (Residential) | 14,107 | 33.1% |
| Transportation (Infrastructure) | 6,733 | 15.8% |
| Electricity | 6,074 | 14.2% |
| Industry | 6,040 | 14.2% |
| Oil & Gas | 5,443 | 12.8% |
| Real Estate (Commercial) | 1,829 | 4.3% |
| Water & Sanitation | 1,317 | 3.1% |
| Health | 757 | 1.8% |
| Agriculture | 244 | 0.6% |

Perhaps another sign of the growing maturity of the Iraqi marketplace, however, is that aside from residential real estate, foreign commercial activity was relatively even among the other top sectors. Transportation infrastructure (including sea, air, roads and rail), electricity and industry (particularly materials like cement and steel) are all important foundations for Iraq's reconstruction, and are all drawing major interest from foreign firms and investors.

Furthermore, and this is a particularly welcome contrast to previous years, investments in industry are becoming smaller-scale and more targeted. Unlike proposals seen in past years for "industrial cities" or "mixed investment projects" that promised billions of dollars, 2010 gave rise to numerous investments and service contracts involving specific factories or manufacturing plants. Many of these, like the $220 million Lafarge/Merchantbridge investment in the Karbala cement factory, are already yielding concrete results.

## Baghdad and Basra Remain Economic Centers

As the seat of government and with an estimated 18 percent of Iraq's population, Baghdad drew the largest share of foreign commercial activity in 2010, followed closely by Basra and its surging hydrocarbon economy. While there is strong foreign commercial activity across various sectors in Baghdad, deals there have focused on rebuilding infrastructure (roads and sewers) and tackling the

[7] The "Iraqi Housing Market Study" by UN HABITAT and the World Bank was published in December 2006.

massive housing crisis. Basra, on the other hand, is booming from not only oil and gas sector development, but also because of the massive electricity, industrial and infrastructure projects required to support that development. There were 43 reported Basra-specific deals in 2010 — more than twice Baghdad's 18.[8]

However, 2010 also saw the continuation of a positive trend: the increase in foreign commercial activity outside of these traditional commercial centers. The Kurdish region of Iraq continued to attract significant numbers of foreign firms (particularly from Turkey, but also Jordan, South Korea, China and the UAE), as well as a healthy balance of deals valued both above and below $1 billion. Although a ban on exports from the region's oil fields continued throughout the year, the Kurdish region in 2010 saw continued investment in its oil and gas sector, as well as significant investment in industrial manufacturing and transportation. Indeed, there were at least three announced deals in steel manufacturing valued at a combined US$1.342 billion.

**Table 3. Governorate Breakdown of Foreign Commercial Activity[9]**

| *Governorate* | *$ (millions)* | *% Total* |
|---|---|---|
| Baghdad | 16,965 | 39.8% |
| Basra | 14,702 | 34.5% |
| KRG | 2,960 | 6.9% |
| Karbala | 1,738 | 4.1% |
| Maysan | 1,430 | 3.4% |
| Wassit | 1,226 | 2.9% |
| Najaf | 1,177 | 2.8% |
| Muthanna | 682 | 1.6% |
| Ninewa | 633 | 1.5% |
| Diwaniya | 479 | 1.1% |

Relatively good security conditions and the presence of hydrocarbons remain the strongest determinants of foreign commercial activity across Iraq. As such, there is increasing activity in Maysan and Wassit governorates (which have oil fields actively under development), as well as Karbala and Najaf, whose relative safety and religious tourism industries have convinced many foreign firms of the strength of their local economies. At the same time, the deals in these latter provinces are not merely in the hospitality industry, but also in industrial manufacturing (the aforementioned cement factory in Karbala) and transportation (Najaf in July 2010 awarded a Canadian firm a $600 million contract to build the city's first monorail).

While smaller-scale foreign commercial activity was reported in governorates such as Muthanna, Diwaniya and even Ninewa (which has the highest average rates of violence in Iraq after Baghdad),

[8] Having achieved initial (and relatively inexpensive) 10 percent boosts in oil production, IOCs are expected to begin more significant investment in order to achieve much larger plateau production targets. Construction of additional production, storage, transportation and export infrastructure, as well as investments in water injection, natural gas capture, electricity production and other critical infrastructure, must all proceed at a rapid pace within the next few years if Iraq has any hope of achieving an expected 4.5 million barrels per day by 2015. This will continue to drive increases in foreign commercial activity in Basra relative to other governorates in Iraq.

[9] Other provinces that recorded foreign commercial activity (<1%) were: Salahaddin, Dhi Qar, Babil, Anbar and Diyala.

  

one governorate that is surprisingly absent from the 2010 rankings is Dhi Qar. The governorate not only enjoyed some of the lowest levels of violence, but is also home to the Gharraf oil field under development by Petronas and JAPEX. In 2009, Dhi Qar was home to several multi-billion dollar real estate and mixed-industrial investment proposals, but nearly all of these apparently failed to come to fruition. While there were a handful of smaller (multi-million dollar) real estate and industrial deals this year, the local council voted to dissolve the investment commission due to its poor performance at the end of June 2010. The governorate therefore perhaps best serves as an example of the high degree of uncertainty that still exists as foreign firms look to operate beyond the major commercial centers of Baghdad and Basra.

## III. Investments by the Numbers: Deals Under $1 Billion

Although there were far fewer multi-billion dollar deals announced than in previous years, the proliferation of relatively small ($100 - $300 million) deals means that the five deals in 2010 that were valued at more than $1 billion somewhat distort foreign commercial activity in Iraq. As such, the following analysis of deals valued at less than $1 billion is presented to eliminate such exaggerated effects and to offer a supplemental view of emerging trends in Iraq.

**Table 4. Geographic Distr. and Value of Foreign Commercial Activity in Iraq [<$1 billion]**

| *Country* | *$ (millions)* | *% Total* |
|---|---|---|
| Turkey | 3,603 | 20.6% |
| France | 2,743 | 15.7% |
| USA | 1,997 | 11.4% |
| China | 1,736 | 9.9% |
| UAE | 1,318 | 7.5% |
| Canada | 1,247 | 7.1% |
| UK | 1,215 | 6.9% |
| Australia | 883 | 5.0% |
| Russia | 752 | 4.3% |
| Italy | 692 | 3.9% |
| South Korea | 269 | 1.5% |

Once the larger deals are stripped away, Italy and South Korea (which recorded the $4.6 billion Technital and $3 billion STX Heavy Industries deals respectively) fall into the second tier, replaced by China and the UAE. These latter two countries each recorded significant numbers of deals valued at under $1 billion (11 and 14 respectively), and while the UAE's central role in Iraq's post-war economy is not surprising, 2010 saw Chinese commercial activity expand well beyond its already sizeable role in Iraq's oil and gas sector. Among the largest deals: in May 2010, China's Shanghai Electric started work on a $924 million power plant project in Wassit; in August, the China National Building Material Co. began construction of a $270 million cement factory in Muthanna; and in December, the Sinoma (Suzhou) Construction Co. signed a $112.5 million deal to construct a cement factory in Sulaymaniyah.

While the United States recorded more than 11 percent of the total value of deals under $1 billion, as discussed above, this is still largely due the strong showing by US firms in Iraq's expanding oil and gas sector deals (which, as also noted earlier, is dominated by smaller deals). Perhaps most significant, however, is the continued presence of Turkey at the top of the rankings. All but one of its 22 deals were valued at below $1 billion dollars (averaging $163.8 million), and involved every major sector of the economy, which further underscores the diversity of Turkey's rapidly growing commercial interests in Iraq.

  

| Table 5. Sector Breakdown of Foreign Commercial Activity [<$1 billion] | | |
|---|---|---|
| *Sector* | *$ (millions)* | *% Total* |
| Oil & Gas | 5,443 | 25.7% |
| Electricity | 4,574 | 21.6% |
| Real Estate (Residential) | 2,827 | 13.3% |
| Transportation (Infrastructure) | 2,133 | 10.1% |
| Industry | 1,940 | 9.2% |
| Real Estate (Commercial) | 1,832 | 8.7% |
| Water & Sanitation | 1,317 | 6.2% |
| Health | 757 | 3.6% |
| Agriculture | 244 | 1.2% |

In both the sector and governorate breakdowns, the central role of the hydrocarbon industry is clearly visible as Basra and the oil and gas sector take the top spots. As noted earlier, the volume of oil and gas deals (at 28) clearly outpaced all other sectors, but the average deal value at $194.4 million disguised that level of activity when compared to the total value of deals across all sectors. In the coming years, however, as oil field development in Basra and other southern governorates accelerates, this sector is expected to rival, if not exceed, residential real estate as the principle focus of foreign commercial activity. This trend will only intensify once third round and possibly fourth round fields also begin development, and initial related infrastructure investment has taken place as well. However it is also hoped that in the next five years, growing hydrocarbon revenues will help unlock growth in various sectors across Iraq and diversify the country's economy from the total dominance of oil and gas.

Another important difference that emerges when looking at deals under $1 billion is the strong showing of the electricity sector. There are now four privately owned power plants in Iraq (up from zero in 2008), accounting for some 13 percent of Iraq's electricity supply. French, Turkish and Italian firms signed deals this year to install new turbines or otherwise upgrade existing electricity infrastructure in Basra, Karbala, Najaf, Ninewa and Baghdad — deals which are reflected in the data above.

Iraq is in critical need of major investment in this sector, with daily supply averaging 6,300 megawatts (MW), or less than half of estimated peak demand. Following chronic shortages and blackouts this summer, the former minister of electricity was forced to resign in late June 2010 after riots in Basra resulted in the deaths of two protestors. Iraq's draft budget for 2011 allocates $3.2 billion to the Ministry of Electricity (a 38 percent increase over 2010) and the government is soon expected to release a master plan for meeting national demand by 2014, and adding a total 12,000 MW of electricity over the next decade. According to the ministry, 5,000 MW will be added via "independent power projects" owned and operated by private companies, 5,700 MW will come from plants built by private firms, but owned and operated by the ministry, and another

  

1,000 MW will come from upgrades to existing power stations. However, ministry officials have stressed that little of this additional capacity will come online before 2013.

| Table 6. Governorate Breakdown of Foreign Commercial Activity [<$1 billion][10] | | |
|---|---|---|
| *Governorate* | *$ (millions)* | *% Total* |
| Basra | 5,310 | 29.9% |
| Baghdad | 3,281 | 18.5% |
| Karbala | 1,647 | 9.3% |
| KRG | 1,557 | 8.8% |
| Maysan | 1,355 | 7.6% |
| Wassit | 1,161 | 6.5% |
| Najaf | 1,115 | 6.3% |
| Muthanna | 647 | 3.6% |
| Ninewa | 600 | 3.4% |
| Diwaniya | 454 | 2.6% |
| Salahaddin | 380 | 2.1% |

Another 2010 trend seen more clearly in the under $1 billion data is the relative increase in foreign commercial activity in governorates beyond Baghdad, Basra and the Kurdish region. Indeed, the total value of such foreign commercial activity in Karbala actually exceeds that of the Kurdish region, while Maysan, Wassit and Najaf are not far behind.

This reflects two things: first, that the Kurdish region in 2010 saw the approval of a $1.1 billion deal with Jordan's Mass Global and Italy's Danieli & Co. S.p.A. to build a smelter and steel plant in the Chamchamal area between Kirkuk and Sulaymaniyah; and second, that there is a genuine increase in the number of reported deals that are flowing to Karbala and other more stable southern governorates. For instance, Karbala in 2010 saw not only the $220 million Lafarge cement factory deal, but also the $445.5 million deal with Turkey's Calik Enerji to build a power plant and install 10 turbines, as well as deals with UK, Chinese, German, UAE, French and US firms across nearly every economic sector.

Clearly, these foreign firms are betting that increased security and political stability, coupled with near double-digit GDP growth that is anchored by rising oil export revenues, will benefit these southern governorates — just as stability and peace has benefited the Kurdish region of Iraq since 2003. This relative share of foreign commercial activity in southern Iraq is expected to grow significantly over the next five years.

[10] Other provinces that recorded foreign commercial activity (<1%) were: Dhi Qar, Babil, Anbar, Diyala.

## IV. Year-on-Year Change in Foreign Commercial Activity

The total $42.668 billion in reported foreign commercial activity represented an increase of $13.968 billion (or 48.7 percent) in total deal value over 2009.[11] While the growth rate slowed, the nominal increase in deal value was $3.2 billion greater between 2009 and 2010 than between 2008 and 2009.

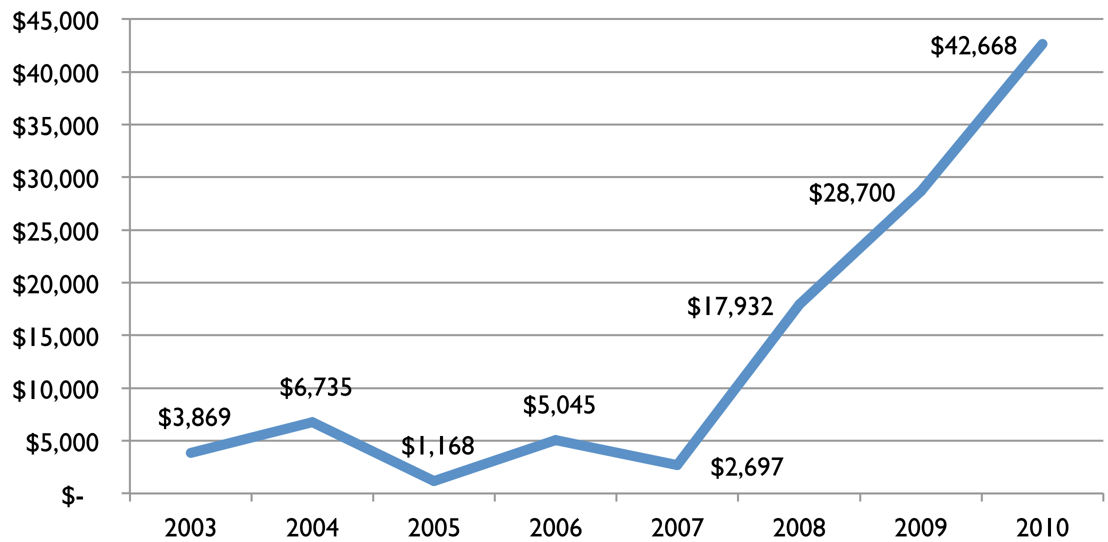


Figure 4. Value of Foreign Commercial Activity in Iraq, 2003 – 2010 ($ *millions*)

The catalyst for the acceleration of foreign commercial activity was the end of major violence in Iraq in 2008, and continued relative tranquility in the years ahead will help further increase the value of future commercial activity. Additionally, as IOCs and OSCs move forward with oil field development in southern Iraq, including massive upgrades of oil export infrastructure, the real magnitude of the investment in these fields will be registered through massive new service contracts and related outlays in the years ahead. A more mature hydrocarbon sector and robust infrastructure backbone will, in turn, anchor broad-based economic development that can drive future foreign commercial activity in sectors such as real estate, industry, and transportation, among others.

While the growth rate of foreign commercial activity is expected to remain above 30 percent in 2011 and possibly through 2012, Dunia expects this surge in activity in Iraq among foreign firms and investors to peak by 2015 and subsequently mirror overall GDP growth rates for the remainder of the decade. With the International Monetary Fund projecting a real GDP growth rate of 11.5 percent in 2011, the value of foreign commercial activity could exceed $100 billion per annum during the second half of this decade.

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[11] See Appendix 1: Note on Methodology for an explanation of calculating deal value for previous years.

## V. Oil & Gas Sector Update

### Third Petroleum Licensing Round

Iraq's Oil Ministry successfully auctioned off three natural gas fields in October 2010, despite delays in the auction process and widespread doubts in the government's ability to attract buyers at a favorable price. Only 13 international oil companies were eligible to bid, as opposed to 45 in the second petroleum licensing round; still, although it received just two bids each for the Akkas field in Anbar and the Siba field in Basra, and just one for the Mansuriyah field in Diyala, the Oil Ministry was still able to secure favorable terms.

A consortium split 50-50 between South Korea's Kogas and KazMunaiGas of Kazakhstan won the largest field up for auction, the Akkas lot with its 5.6 trillion cubic feet of proven gas reserves. The two firms agreed to a remuneration fee of $5.50 per barrel of oil equivalent (pboe) produced, even lower than the US$8.50 suggested by the Iraqi government. The Siba field in Basra, near the Kuwaiti border, went to a consortium of Kuwait Energy (60 percent) and Turkey's TPAO (40 percent) with a remuneration fee of $7.50 pboe. Finally, the Mansuriyah field attracted only one bid, from a consortium of TPAO (50 percent), Kuwait Energy (30 percent) and Kogas (20 percent) with a remuneration fee of $7.00 pboe.

Iraq hopes to develop the natural gas from the fields, which combined account for only about 10 percent of the country's estimated 112 trillion cubic feet of reserves, for power generation and as a feedstock for industrial plants. Iraq currently processes only 500 million cubic feet per day (cfpd) of natural gas; the third round licensing deals would add another 820 million cfpd if they reach their full potential. Iraq expects production at the auctioned fields to reach 25 percent of stated targets within three years, with final production plateaus to be hit in six years.

However, delays in forming a government prevented the Iraqi cabinet from approving the contracts for the deals before the end of 2010. Indeed, only the contracts for Siba and Mansuriyah appear to be set for approval, as political squabbling in Anbar stalled the Akkas deal. The Oil Ministry had expected to sign a preliminary deal for Akkas on November 14, but vehement objections from the local government have caused delays. Officials in Anbar had independently courted and received offers from foreign firms to develop the gas field, including reports of a $60 billion offer from a Korean consortium and another group from the UAE to build an industrial city in addition to gas production, storage and processing facilities. The Kogas/KazMunaiGas team is expected to invest only about $10 billion in the province, and the predominantly Sunni Arab governorate of Anbar remains wary of Baghdad and plans to centralize revenue and potentially export natural gas rather than dedicate it to domestic electricity production.

The Oil Ministry is also still negotiating a separate $12 billion deal with Royal Dutch Shell and Mitsubishi to potentially capture as much as 5 billion cfpd of associated gas from the country's major oil fields. The deal, which initially would focus on capturing 700 million cfpd of associated gas now being flared at the cluster of supergiant fields in Basra, has been delayed for over two years because of uncertainties over financing and logistics, as well as Iraqi legal and political hurdles.

  

## Pace of Oil Field Development

By the end of 2010, IOCs operating the four largest oil fields auctioned in 2009 (Rumaila, West Qurna 1, Majnoon and Zubair) all reported reaching the initial production targets stipulated by their contracts with the Iraqi government. At Rumaila, which was the first field to begin redevelopment, BP and CNPC boosted output 17 percent to 1.25 million bpd in 2010, already exceeding production targets set for mid-2011. About 4,000 personnel are working at Rumaila, 3,400 of whom are from Iraq's South Oil Co. Thousands of additional contractors and laborers are now also working at the site. BP reported that 41 new wells were drilled in 2010, and the first phase of a new headquarters and housing complex has been completed, in addition to mine-clearing and environmental surveys.

At West Qurna 1, ExxonMobil and Royal Dutch Shell in November raised their projected production peak for Phase 1 of the field by 500,000 bpd to 2.825 million bpd, by tapping additional reservoirs. The consortium intends to reach output of 270,000 by May 2011, up from initial production levels of 244,000. The Italian firm Eni and its partners have boosted production at Zubair by nearly 50 percent in their first year of operations, from 184,000 to 265,000 bpd. At Majnoon, Royal Dutch Shell and Malaysia's Petronas have raised output from 45,000 to 70,000 bpd, and have signed a deal with Halliburton to build an operations camp and drill at least 15 wells.

## Projections of Future Output

While Iraqi officials continue to insist that the country can achieve oil production of 8 million bpd by 2017, several studies released in 2010 (including by Dunia) have dismissed those projections as wildly optimistic considering the major infrastructure bottlenecks and logistical challenges that still face the country. The consensus now indicates that Iraq will be lucky to pass 2.6 million to 2.8 million bpd by the start of 2012. Iraqi production is currently about 2.4 million bpd, with exports averaging around 1.95 million bpd.

Meanwhile, the International Energy Agency (IEA) in its November 2010 World Energy Outlook said Iraq would be unlikely to reach 7 million bpd before 2035, and that Iraq's current official projections would require investment levels of around $150 billion over the next five years. Even reaching half that level of production would require massive investment, including thousands of kilometers of pipeline, several thousand wells, dozens of drilling rigs and associated materials and heavy equipment, massive water pumping and injection systems, and thousands of tons of mud, cement and chemicals. Power stations, industrial zones, workshops, warehouses, work camps, residential areas and roads to support the industry are also needed. An estimated $12 billion is required just to build the export infrastructure required for 4.5 million bpd.

## Hydrocarbon Disputes with the Kurdish Region

While southern Iraq enjoyed the first murmurs of an oil boom, all of 2010 passed without good news for the oil industry in the Kurdish region of Iraq. Oil exports from the region had been halted since October 2009 due to continued disagreements over revenue sharing and the transparency of independently negotiated production sharing agreements between IOCs and the KRG. Despite repeated suggestions from Prime Minister al-Maliki and the KRG that a deal was on the horizon, it was only on February 3, 2011 that oil exports from the Kurdish region returned. Production gradually resumed at the Tawke oil field, operated by Norway's DNO International and Turkey's Genel Enerji, and the Taq Taq field operated by Addax Petroleum, a subsidiary of China's Sinopec Group, reaching over 80,000 bpd within the first week — 50,000 bpd of which was exported via the Ceyhan-Kirkuk pipeline. Tawke and Taq Taq, the Kurdish region's two productive fields, are reportedly capable of producing as much as 250,000 bpd by year's end. The fields were generating a total of 50,000 bpd when exports were halted in October 2009.

The return of exports benefits both the KRG and the central government through increased revenues, but the exact terms of the latest deal remain unclear. Although Prime Minister Maliki suggested in an interview published February 5 that the central government would honor agreements signed independently between the KRG and IOCs (which promise profit sharing rather than the per-barrel service fees that the central government offered in its technical service contracts), this apparent concession was quickly denied by Deputy PM Shahristani and others in the Ministry of Oil. However, the deal does commit the Kurds to initial production of only 100,000 bpd though the central government had hoped for 150,000 bpd, but the Kurds had argued that was too high.

If this deal marks a permanent thaw in Erbil/Baghdad relations on this issue, it could unleash a flood of IOC activity in the north as firms finally could proceed unconstrained with exploration and drilling, as well as mergers and acquisitions. The agreement also could be disruptive to the oil sector, though, if other regions (Anbar, for instance) decide they also want to negotiate oil or gas deals on their own terms. While the latest news is very encouraging, Iraq cannot count on Kurdish oil exports until a more detailed revenue-sharing plan emerges. Iraq still lacks an overarching hydrocarbons law to govern energy-sector development and distribution of revenues. It is important to remember that the last time the central government and the KRG reached an agreement on exports, it lasted just five months before collapsing.

## Appendix I: Top 30 Deals in 2010

Table 7. Top 30 Deals in 2010

| *$ (millions)* | *Companies/Investors* | *Country of Domicile* | *Investment* | *Industry* | *Province* |
|---|---|---|---|---|---|
| 11,280 | Kur Insaat, Kazova Insaat, Iskaya AS,Kocoglu Insaat | Turkey | 75,000 housing units in Sadr City reconstruction | Real Estate | Baghdad |
| 4,600 | Technictal | Italy | Al-Faw port construction | Transportation | Basra |
| 3,000 | STX Heavy Industries | South Korea | Basra plastics factory construction | Industrial | Basra |
| 1,500 | Alstom | France | Power plants and infrastructure modernization | Electricity | *Multiple* |
| 1,100 | Mass Global / Danieli | Jordan / Italy | Chamchamal smelter and steel plant | Industrial | KRG |
| 966 | *Unnamed* | France | Rusafa water project | Water & Sanitation | Baghdad |
| 924 | Shanghai Electric | China | Power plant | Electricity | Wassit |
| 750 | Acarsan Group | Turkey | Five hospitals | Health | *Multiple* |
| 733 | Leighton Offshore Private | Australia | Oil export terminals | Oil & Gas | Basra |
| 700 | Wintercroft Capital | Russia/Switzerland | Two thermal power plants | Electricity | Maysan |
| 600 | TransGlobim International | Canada | Najaf monorail | Transportation | Najaf |
| 446 | Çalık Energy | Turkey | Power plant and installation of 10 turbines | Electricity | Karbala |
| 340 | Gulftainer | UAE | Umm Qasr containerdock | Transportation | Basra |
| 318 | TPIC | Turkey | Drill 45 wells in the Rumaila oilfield | Oil & Gas | Basra |

| | | | | | |
|---|---|---|---|---|---|
| 299 | Iraqcan | Canada | 5,000 housing units | Real Estate | Baghdad |
| 296 | Copperchase | UK | 3,000 housing units | Real Estate | Najaf |
| 270 | China National Building Material Co Ltd | China/Iraq | Cement factory | Industrial | Muthanna |
| 268 | Enka Insaat | Turkey | Power plant and installation of 6 turbines | Electricity | Ninewa |
| 250 | Akkon / East Building [JV] | Turkey / UAE | Sale of lightweight, steel-framed houses | Real Estate | *Multiple* |
| 238 | Amwaj International Company | Iraq / Jordan / UAE | Hotel and 3,000 housing units | Real Estate | Baghdad |
| 224 | Weatherford | USA | Contract to drill 20 wells in al-Bazrakan oilfield | Energy | Maysan |
| 220 | World Solutions International | USA | 2,500 housing units | Real Estate | Basra |
| 220 | Merchantbridge / LaFarge | UK / France | Refurbishment of Karbala cement factory | Industrial | Karbala |
| 205 | Eastern Lights | Turkey | Install four turbines at existing power plant | Energy | Baghdad |
| 200 | Weatherford | USA | Contract to drill wells in the Rumaila oilfield | Energy | Basra |
| 200 | Schlumberger | France | Contract to drill wells in the Rumaila oilfield | Energy | Basra |
| 195 | Calik Holding / GAP İnşaat | Turkey | Renovation of 19 km BIAP highway and landscaping | Transportation | Baghdad |
| 175 | UI Energy | South Korea | Purchased stake in three oilfields from Genel Enerji | Energy | KRG |
| 130 | ArcelorMittal / Dayen Dis Ticaret Ltd. | Luxembourg/Turkey | Construct new steel mill near Sulaymaniyah | Industrial | KRG |
| 120 | Elegan Turizm / Koç Holding / Divan | Turkey | Luxury hotel in Erbil | Real Estate | KRG |

## Appendix II: Note on Methodology

### Definition of Foreign Commercial Activity

Dunia's intent in producing these reports is to assess the changing economic landscape in Iraq, with a particular focus on the financial activities and interests of foreign firms and investors. As the process of reconstruction in Iraq began in earnest in 2010, many of the more interesting deals and contracts being concluded (from the perspective of a foreign firm or investors looking for business opportunities) were not in private foreign investment, but instead in Iraqi government or private-sector service contracts, production sharing agreements, lease agreements, or foreign partnerships with private Iraqi investors. Furthermore, increasingly complex and opaque financing (soft loans by foreign governments, conditional or staggered project financing, etc.) further undermined simple "foreign investment" as a meaningful category of economic activity in Iraq.

Dunia therefore chose to collect and analyze data under the umbrella category of "foreign commercial activity," which includes investments, service contracts and other revenue-generating activities that involve foreign-domiciled firms operating in Iraq. However, because this category is necessarily much broader, and because there were so many multi-billion dollar deals in 2008 and 2009 that never came to fruition, Dunia also embraced a stricter set of criteria for reporting on new deals. Perhaps the most concrete illustration of such a criterion is the decision to record oil and gas sector investment on a project-by-project basis rather than "booking" the total estimated value of investment in a particular field, which is intended to avoid double counting of such investment in future iterations of this report. Additionally, Dunia chose to report only those projects which have either actually broken ground or which have seen final contracts signed — rather than simply memoranda of understanding, or investment licenses issued by the governorates (although final contracts themselves offer little guarantee that the deal will go forward in a market as challenging as Iraq). In order to produce the year-on-year growth figures presented in Section IV, Dunia also applied these criteria to previously collected data. This not only eliminates the first round oil fields from 2009 (pushing related investment into 2010), but also strips away many of the multi-billion dollar real estate and industrial deals that failed to materialize. It is for this reason that capital commitments recorded for 2009 in this report are less than 20 percent of their previous reported levels.

### Estimating Unreported Deal Size

Another issue which arose during data collection in 2010, and which is likely to become more of an issue as Iraq's economy grows and attracts a more diverse array of foreign firms and investors, is the large number of deals for which no financial details are released. In this year's data set, 32.3 percent of the 164 reported deals had no assigned monetary value. This is a function both of natural secrecy sought and in some case required by businesses, but also the poor reporting environment in Iraq.

In order to compensate for these lacunae, Dunia employed a sector-specific strategy for analysis, comparing pools of similar contracts and investments to estimate the unreported value of such deals. While this approach is no guarantee of accuracy, it ensures an apples-to-apples comparison that is more likely to be accurate. In this sense, it was particularly important not to compare all deals across an individual sector (which in the case of electricity ranges from $1.5 billion to $23 million), but rather only those deals that were truly comparable in scope. Following this approach, the top-line figure of $42.668 billion dollars is an estimate of total foreign commercial activity across 164 reported deals based on actual reported deal value of $34.204 billion.

### Observational Biases and Errors

To produce its reports on the Iraqi economy, Dunia collects and analyzes data from a combination of publicly available regional, Iraqi, and industry-specific media, as well as private sources. However, given the source and nature of the data collection, it is inevitable that there are observational biases that produce inaccuracies in the assessment of Iraq's economy. For example, the number of reported deals by Iranian firms (at $536 million in 2009 and just $20 million in 2010) is totally contrary to what any reasonable observer would expect given the high levels of cross-border trade, as well as close political ties, between the two countries. At the same time, Iranian business interests are highly sensitive given the international embargo against that country and internal political dynamics in Iraq. It is highly likely, therefore, that many Iranian firms are not eager to broadcast their activities, and will therefore lag in any analysis of this sort.

In the same vein, there are likely many single- and double-digit multi-million dollar deals across Iraq which have been signed or finalized, but which were never publicly reported, and are therefore not reflected in the dataset presented in this report. As noted above, however, the data presented here are not intended to be exhaustive, but instead to reflect emerging trends and to provide useful insights into how the Iraqi economy is evolving.

## About Dunia

With offices in Washington DC, Dubai and Kampala, Dunia Frontier Consultants (DFC) provides consulting services to investors and corporations operating at the frontiers of 21st century business.

We understand that obtaining accurate, actionable information on rapidly changing frontier markets is challenging and time consuming. DFC eliminates these issues and enables you to focus on your core competencies: structuring and executing deals and managing your operations.

Dunia works closely with a small number of clients internationally to provide an unparalleled level of service. With a world-class staff and highly efficient global network of consultants and partners, we support your endeavors in several key areas:

- **Emerging Markets Investment**. The heart of our business, we offer our clients a full suite of financial services, including deal sourcing, due diligence, valuation, and market survey support;
- **Risk Reporting and Analysis**. Anchored by rigorous data collection and subject matter expertise, we organize and deploy research teams across the Middle East, Africa and South Asia to offer our clients recurrent information to mitigate risks and optimize decision-making in key transactions;
- **Business Development**. With well-developed local business networks in the world's financial capitals and across key emerging markets, we identify prime market opportunities and business partners for our clients, as well as provide essential insights to help them navigate new markets.
- **Information Networking and Design**. We develop and refine research methodology and analytic tools to generate useful information for clients operating in data-poor and challenging business environments.

### Dunia in Iraq

Dunia has performed dozens of due diligence and market surveys in the agriculture, oil and gas, manufacturing, logistics, and real estate sectors of Iraq. Dunia recently completed an in-depth survey of the upstream oil and gas sector, a number of surveys of the housing and real estate markets of non-Baghdad locals, and continues providing actionable Round IV insights on developments in the Ministry of Oil, its operating entities, and with comprehensive analyses of the on-the-ground situation surrounding the major oil fields under development.

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