

Oil prices – and oil juniors – gain from deepening crisis in Iraq

☒ Last week, oil prices increased sharply as the WTI Light Crude price rose 5% (it is now above USD 107/barrel) and North Sea crude rose by almost 6% (now above USD 113/barrel). The strong upward pressures on gold black are linked to geopolitical tensions in the Middle East; more specifically, in Iraq, which is the second largest oil producer in OPEC.

The oil price spike has benefited many oil juniors and none more so than oil juniors that have already been able to raise production revenues and volumes in 2014. Tuscany Energy Ltd. (TSXV: TUS) is one of these and at the end of May it reported improved quarterly (first quarter) results compared to a year ago. Revenues increased to \$4.1 million in 2014 from \$1.3 million in 2013 while cash flow reached USD\$1.8 million up from USD\$0.3 million in 2013. Tuscany is a horizontal drilling specialist. Tuscany intends to start development of the newly acquired prospects because of their very promising potential around the middle of the summer thanks also to the fact that the area has a productive gas well that will be able to fuel generators reducing the operational costs of developing the new pools and those already underway at the Macklin site.

While 2014 suggests Tuscany is improving – and the geopolitical climate of uncertainty in the Middle East will continue for some time – it is important to note that Tuscany showed strong performance in 2013 with record sales, more than double those of 2012. The fact that Tuscany has improved on such optimal results should only add further confidence. Tuscany has a 100% working interest in nine producing horizontal heavy oil wells and four other – closed – wells which will reopen when infrastructure is implemented to

connect the wells to water facilities this year. Horizontal drilling is one of the keys of Tuscany's future growth. The technique is relatively new in the oil sector and it allows producing reservoir rocks at greater length and thus producing a greater amount of oil at the same time.

Oil prices are not likely to stop rising and could set new records because neither the Iraqi government nor the rest of the world powers with interests in Iraq, including the United States and Iran have any effective solution to stop ISIS, which is edging ever closer to Baghdad. ISIS wants to establish a caliphate in a swath of territory between Iraq and Syria. It will be difficult in the short term to ease tensions in the wake of meek U.S. response. President Barack Obama has, in fact, has ruled out deploying US troops, urging the Iraqi government to use more drones instead. Meanwhile, as if the refugee problem had not become untenable enough in Syria, more than 500 thousand Iraqis have fled their homes to reach safer areas. Should the United States or NATO respond – unlikely – more firmly, getting involved into what is a sectarian conflict, which could have repercussions from Lebanon to Saudi Arabia and Bahrain, oil prices will not halt their climb; indeed, they may rise even more sharply.

ISIS, a Sunni jihadist militia (Islamic State of Iraq and Syria – also often called ISIL) is marching towards the capital Baghdad, seemingly unhindered by either the official Iraqi army or by Shiite militias organized 'on the fly'. ISIS has already managed to occupy parts of north-western Iraq, including Mosul, one of Iraq's largest cities, which is close to the large gasoline refinery in Baiji. ISIS's invasion of northern Iraq has also blocked repairs to the pipeline running from the oil fields of Kirkuk to the Turkish port of Ceyhan on the Mediterranean.

The root cause of the problem lies in the fact that militias have been allowed or even encouraged to arm themselves indiscriminately in Syria while the post-Saddam Iraq has

failed to develop a democracy with enduring power. The G.W. Bush administration, and especially its advisors and host of armchair generals, severely underestimated the significant differences of the Iraqi population in religious matters (Sunni and Shiite, which have often fought over influence and power in the Islamic world). The Shiite dominated government and American backed Prime Minister Nouri al-Maliki (who also runs four key ministries and was re-elected last month with a narrow minority) has failed to reach out to the Sunni majority population living of the north-western oil producing regions. Taking into account the already difficult situation in Syria that is hard to normalize, we believe that diplomacy in Iraq will have little room to move and the military confrontation will become more tempting. Alternatively, Obama will have to take the very courageous step of entertaining an offer of cooperation from Iran's president Rowhani, which will be very hard to swallow among Washington's Republican pundits, who have urged the US to get more directly involved.

In early May, Iraqis held their first parliamentary elections of the post-American era. The 'Rule of Law' block headed by Prime Minister Nouri al-Maliki won a small minority victory, which means that the re-confirmed PM will likely spend the better part of a year in forming a government. In the previous election, it took nine months for al-Maliki to form a government. Oddly, in this strange brew that is the Middle East of the post US/NATO liberated Iraq, Prime Minister Nouri al-Maliki is backed by both the United States and Iran, which are, of course, at odds in Syria. Maliki has not managed delivered the 'promised land' in Iraq but he probably earned his latest victory because war weary Iraqis are seeking some kind of constancy in the face of continued interfaith violence and terrorism. Since last December, some Sunni tribes in the al-Anbar region have allied with al-Qaida against the Shiites who hold the majority in Baghdad. Over 2,700 people have been killed in sectarian violence in Iraq since the start of 2013.

The violence in Iraq fuels the fighting in Syria and vice versa. The Sunni insurgency in Anbar province is fueled by the war in Syria while the extreme fringes of the rebellion against al-Asad stem from Iraq. ISIS considers Syria and Iraq to be a single battleground where to establish a Caliphate according to the ideology of al-Qaida. Moreover, Saudi Arabia – and Qatar – is worried about the risk of losing out in oil production, as Shiite ruled and Iranian supported Iraq has been pumping more oil barrels per day than at any time in recent memory. After helping to arm the Syrian rebellion – though this has no doubt been drastically reduced in the past year – the United States has accelerated the delivery of 36 F-16 fighters, 24 Apache helicopters and 500 Hellfire missiles to Iraq to help it deal with ISIS. Terrorism has been one of the flagships of al-Maliki's election campaign, but the prime minister has been accused of marginalizing Sunnis causing the unhealthy alliance between tribes and terrorists in Anbar province. Having earned a narrow victory, he will have to form a much broader coalition engaging Arabs, Kurds, Turkmen, Shiites and Sunnis in order to preserve unity in Iraq and hope to break the Jihadi caliphate nightmare being pondered by ISIS.

ISIS was established in 2003, in the context of the war of Iraq. It has aimed to impose Shari'a in the territories controlled and achieve a great Islamic caliphate, uniting Syria and Iraq in a single state. The final rupture of relations with Al-Qaeda took place in April of 2013 when Ayman al-Zawahiri refuted it, preferring to recognize the Nusra Front. ISIS could even be about to exceed in strength and importance of the mother group of al-Qaeda. ISIS has gained fighters and territory, becoming ever more a reference point for jihadists around the world. ISIS control almost 20 percent of Syrian territory and in particular the oil fields of Hasaka and Raqqa that allow it to smuggle oil, gaining economic and military strength.