

Opportunities in the Middle East

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Good morning, everyone. It's a pleasure to be here at the Goldman Sachs Global Energy Conference 2002.

I'm especially pleased to be back in New York. The spirit and resilience of New Yorkers in overcoming adversity since September 11th is an inspiration to all Americans and has reminded us of the enduring qualities that have made our nation great. New York has long been a beacon to millions of immigrants who have passed through its gates on their way to making the American dream a reality.

As Americans rally to the cause of freedom, media pundits are telling us that the world we once knew has been replaced by a new set of political and economic uncertainties – those unleashed by the twin fears of terrorism and recession. Underlying these uncertainties are concerns that the relationships between the US and key allies in the Middle East have weakened from radical, potentially destabilizing elements within the region. These concerns are accentuated by the dependency of the world's industrial democracies on Middle East oil to fuel the expansion of their economies.

Far from driving a wedge between the US and its allies in the Middle East, the antiterrorism coalition has the potential to establish new common ground that will forge even stronger ties. This could lead to increased privatization and more foreign investment opportunities in that region's energy sector. It's too early to know whether this will be realized. However, in the short run, the fallout from the September 11th attacks has added to the complexity of the energy environment. This has given rise to renewed concerns about energy security in the US.

Despite the geopolitical uncertainties caused by terrorism and global recession, one thing is certain. The Middle East – particularly the region's major energy producers – will remain a focal point of US policy. The US needs the oil and the governments of the oil producing states need the revenues generated by oil exports. And despite renewed interest in Washington in the US becoming energy self-sufficient, there is not the slightest chance of this happening in the oil sector.

While the US has only 3-percent of the world's proven reserves, it is the largest consumer of crude oil and accounts for 25-percent of global crude oil consumption. The US currently relies on imports for 60-percent of its supply of crude oil. There is nothing the US can do that can reverse this trend. Not

only is the US the world's most mature oil producing province, production costs are high – especially relative to the Middle East.

In sharp contrast, the Middle East boasts the world's largest oil reserves with almost 700 billion barrels of proven reserves. That's more than *double* the rest of the world combined. Large areas of the Middle East are either unexplored or under-explored. Not only does the Middle East have the most oil – the oil also is very cheap to get out of the ground – costing \$1 or less per barrel to extract.

Another factor in this equation is that key oil producing countries like Kuwait and Saudi Arabia need the partnership and security umbrella the US offers to support their economic diversification and job creation initiatives. There are unquestionably key policy differences between the US and its friends in the region – and these disagreements often make headline news. But such disagreements are not surprising. The US and its closest ally, the UK, have a history of disagreements, even during wartime. These disagreements do not threaten the foundation of Anglo-American relations because of the overwhelming mutual interests that bind the two nations together. Likewise, the mutual dependency of the US and key Middle East oil producers outweigh any differences.

Before September 11th, a series of important developments had already begun to reshape the climate of the Middle East for foreign investment, particularly the regional trend toward privatization. Saudi Arabia, for example, opened its natural gas sector to foreign investment as part of a broad infrastructure development project that will help diversify the kingdom's economic development and create new jobs. This is the first time the Kingdom has solicited foreign investment in its energy sector since the early-70s.

Kuwait also is moving closer to inviting foreign investment aimed at doubling the producing capacity of its Northern fields. Oman, Qatar and the United Arab Emirates are collaborating with foreign investors to launch new natural gas projects. Large and promising tracts in Yemen remain unexplored, and the government is eager to attract new investment to find and develop new oil reserves. The success of these initiatives will have an important impact on structural changes to drive regional economic diversification.

Occidental has been operating successfully in the Middle East since the discovery of the large oil deposits in Libya in the 1960s. Since that time, we have developed projects in Yemen, Qatar and Oman. We are just beginning an historic, long-term project in the Kingdom of Saudi Arabia. Earlier this year we established a new business development office in Dubai to pursue other regional projects in the UAE and Kuwait.

Occidental has established excellent relations at the highest levels of government throughout the Middle East. We've developed a reputation as creative partners who combine technical skills with cultural sensitivities to create value for the host countries. As far as we're concerned, our relationships in the Middle East have never been stronger.

Today I'm going to focus on the opportunities we see in the Middle East. But first I'd like to give you an overview of our company, the results we've achieved from our restructuring program, and how the restructuring is impacting our growth initiatives in the Middle East.

Restructuring: Occidental is one of the world's largest independent oil and natural gas exploration and production companies. Our growth comes from a combination of exploration success, pioneering work in rejuvenating production in older, mature fields and making timely acquisitions of oil and gas assets and improving their performance. Occidental has established a reputation for completing projects on schedule and on budget.

Today, Occidental Petroleum is a vastly different company than it was just four years ago – different in terms of a sharper focus; different in terms of a stronger asset mix; and different in terms of improved earnings power. All of this is due to the timeliness of our restructuring which focused on expanding and strengthening the company's oil and gas operations that put us in position to maximize the benefits from a strong energy price environment.

The restructuring has worked. Robust energy prices following the restructuring resulted in healthy earnings and cash flow as we dramatically strengthened our balance sheet.

Strategy: Our business strategy has been to focus on large, long-lived, cost-competitive "legacy" oil and natural gas assets in three core areas – the US, the Middle East and Latin America. In the US, Occidental is the largest oil

producer and second largest gas producer in Texas and the largest gas producer in California.

A key component underlying our strategy is the maintenance of financial discipline in every aspect of our business. Financial discipline means that we invest our capital in projects that will produce superior returns. Financial discipline also means maintaining a strong balance sheet to reduce our exposure in a down market.

A third component of our business strategy is to harvest cash from our chemicals business to fund high return growth opportunities in the exploration and production business in areas like the Middle East.

Our oil and gas strategy has three parts, each of which plays an important role:

- First, we continue to focus on adding commercial reserves through the drill bit, but remain highly disciplined in our exploration investment decisions. Our exploration program is driven by the quality of our projects – not by the quantity.
- Second, we continuously evaluate opportunities in our core areas to rejuvenate mature fields with large volumes of remaining oil in place. Our target fields that have the potential of generating superior returns for us and for our host governments. Success in this business requires a clear focus by both our financial and technical staffs.
- Finally, we have a good track record of buying assets with upside potential at attractive prices. We also sell assets that no longer meet our criteria for strong financial performance or meet our broader strategic objectives.

The challenge is to optimize opportunities in each of these areas without compromising our financial discipline. No matter how good the technical data appear, we're prepared to walk away if we can't strike a deal consistent with our goal of top quartile financial performance. This balanced approach translates into a durable and flexible business model because success does not depend on any one or two of the components.

A clear measure of our success is evident in the industry-leading position we've achieved in operating profits per barrel. Based on public data, we moved from well back in the pack to outperform our competitors in 1999.

The result was the same in 2000 with Occidental again at the head of the pack. The only change was the increased gap we put between our performance and that of the other top quartile performers.

Based on our strong performance this year through the third quarter, we expect to remain in the top quartile in profitability for the year. Our performance was driven in large measure by our US operations that were strengthened by key acquisitions.

In 1998, Occidental purchased the Elk Hills field in California for \$3.5 billion. Elk Hills is one of the top ten oil and gas fields in the US and the largest source of gas in California. The Elk Hills acquisition was followed by our \$3.6 purchases of Altura Energy's in Texas and the much smaller THUMS property in Long Beach in April 2000.

We've recovered \$2.4 billion, or 60-percent, of the Elk Hills purchase price and over \$1 billion, or nearly 30-percent, of Altura's purchase price. These are excellent results, but not as good as the results from the THUMS acquisition in Long Beach. This acquisition was much smaller in scale, but we recovered nearly all the \$110 million purchase price in fourteen months.

Today, the US accounts for approximately 55-percent of our worldwide oil production and 92-percent of our natural gas production. Our proven oil and gas reserves are heavily concentrated in the US. The US holds 75-percent of our worldwide oil reserves and 95-percent of our gas reserves.

Debt Reduction: Our ability to capture new business opportunities in the Middle East has been by the strengthening of our asset base and our balance sheet. Since purchasing Altura, we've reduced our total debt by more than \$4 billion dollars. A comparison of year-end 1997 with mid-year 2001 balance sheets reveals that Occidental is the only company to reduce debt while virtually all its competitors have increased their debt levels. Significantly, our total debt calculation includes long-term debt, including current maturities, as well as non-recourse debt, current and non-current gas sale obligations and Trust Preferred Securities.

Our post-Altura pro-forma debt to capitalization rose to 71-percent. By the end of the third quarter this year, we lowered that ratio to 46-percent. Interest expense and preferred dividends have been lowered from \$529 million in 2000 to an annualized rate of \$392 million at the end of the the third quarter in 2001. Lower debt and interest levels strengthen our balance sheet and improve our earnings and cash flow. These improvements provide the financial flexibility to compete successfully for high return projects in the Middle East.

Return on Equity: One of the reasons our stock did not perform in the 1990s was our low return on equity and capital employed. That's clearly changing as you can see by the improvements in our return on equity over the past three years. These improvements are the direct result of the success of our restructuring efforts. Last year alone, our return on equity rose to nearly 38-percent. This year, the estimated return is expected to be 29-percent based on First Call's earnings consensus.

These are huge improvements – but how are we doing in comparison to our competitors? As you can see, our return on equity last year put us in the top quartile.

Return on Capital Employed: Another performance measure is return on capital employed. The pattern is similar to our return on equity. Lackluster performance in earlier years marked by gradual, but steady improvement – has given way to larger increases over the past three years due to the restructuring.

In 2000, our return on capital employed placed us in the middle of the pack among our competitors. I fully expect us to move up in the rankings this year as continued debt reduction reduces our capital employed and earnings remain strong.

Middle East Growth: Large core assets in the US, a strong balance sheet and financial discipline provide Occidental with a sound platform for growth in the Middle East where we're building on our operational success in Oman, Qatar and Yemen. We have one of the strongest positions in the Middle East of any company our size. Our total net oil production in the region is currently averaging about 90,000 barrels per day. This represents about 25-percent of our worldwide oil production. We're continuing to build on our strong foundation in these three countries to compete for new opportunities

in the region. As I noted earlier, we've recently opened an office in Dubai to coordinate our new business development activities throughout the Middle East.

By now I'm sure many of you are aware that Occidental was one of eight western oil companies to win a stake in Saudi Arabia's Natural Gas Initiative. This marks the first time the Kingdom has opened its doors to foreign investment in the energy sector since the 1970s. Saudi Arabia is the world's biggest hydrocarbon province with the world's largest oil reserves and fourth largest natural gas reserves. On June 3rd, 2001, I joined the CEOs of the other companies in Jeddah, to sign preliminary agreements covering the three huge projects that make up this Initiative.

The Saudi leadership made it clear that they expect the partnership to be a rewarding experience for all participants that will open the door to other investment opportunities. I'd like to show you why we're enthusiastic about our prospects for future growth in the Middle East – especially the Arabian Peninsula.

The Arabian Peninsula is the world's largest hydrocarbon province in terms of proved reserves. Of even greater significance is the fact that large areas of the Peninsula are either unexplored or under-explored.

Occidental's areas of interest in Oman, Qatar, Yemen and Saudi Arabia are shown in yellow. All the blocks in Saudi Arabia and Yemen are located in under-explored areas. We also are pursuing new business opportunities in the United Arab Emirates and Kuwait.

Saudi Arabia: Let's look first at the project in Saudi Arabia. Occidental has a 20-percent interest in the Core Venture 2 consortium, which will be investing in the Red Sea area. ExxonMobil is the lead partner with a 60-percent interest and Marathon holds the remaining 20-percent stake. The Red Sea venture involves development of discovered gas from the Midyan and Barqan fields in the northwest part of the Kingdom, and construction of related gas processing and pipeline facilities. The consortium expects to build at least one power plant and a water desalination unit, as well as evaluate the potential for a petrochemical plant.

The project also calls for onshore and offshore exploration in Blocks 40 to 49 located in and along the Red Sea. Exploration success in these blocks

will lay the foundation for additional investment opportunities in power generation, water desalination and petrochemicals in the western part of the Kingdom.

The project's potential is enormous given the geology of the region and the rapidly growing local market. The Kingdom currently consumes about 4 billion cubic feet of natural gas per day and expects that number to rise to 7 billion cubic feet per day in 2003. Current estimates indicate the Kingdom will need from 12 to 14 billion cubic feet per day to meet its projected power generation needs in 2025.

The Kingdom has emphasized that the companies were selected as long-term, strategic partners and each company in Core Venture 2 will participate in all segments of the venture. The Saudis have also stressed that participation in the Natural Gas Initiative will open the door for other projects in the Kingdom.

Saudi leaders see these projects as the beginning of an important phase of the Kingdom's industrial development. This phase will focus on further development of the Kingdom's natural gas reserves to diversify and expand industrial development – and to create thousands of new jobs for Saudi citizens. Currently, Saudi Arabia faces 15-percent unemployment and the population is growing at an annual rate of 3-percent. Approximately 20-percent of those unemployed are under \ age 30. The Saudi leaders realize that they must diversify quickly in order to support the needs of this growing population.

For Occidental, participation in the Red Sea project means an attractive return on investment and an even stronger presence in one of our core areas. The expected integrated rate of return for the project – which includes upstream, midstream, and downstream components – will make them competitive with rates of return for other energy projects around the world.

The Saudi leaders recognize this important consideration and want their partners to be successful so that the companies will be encouraged to continue to invest in the Kingdom for many years to come. Given the reasonable level of risk involved, and the expectation of quite attractive returns, Occidental is very excited about the opportunity to participate in the Kingdom's historic Natural Gas Initiative.

Oman: In Oman, exploration success in Block 9 has made Occidental the largest private oil producer in the country. Occidental's discovery of the 300-million barrel Safah Field in the mid-eighties followed a string of failures by other companies in Block 9. Since the Safah discovery, our geoscientists and engineers have continued to add recoverable reserves in the field. In addition, Occidental has discovered a series of smaller fields in the southern portion of the block. Occidental has produced more than 150 million gross barrels from the Block, most of it from the Safah field. Net production to Occidental is currently averaging about 10,000 barrels of oil per day.

In developing these fields, Occidental has utilized multi-lateral horizontal wells to increase production and recovery rates. Horizontal drilling improves production rates and minimizes the number of wells needed. Today, 60-percent of Occidental's production in Oman relies on horizontal wells. One 5,000 feet long horizontal section set a record for the Middle East.

In June 1998, we signed a contract for a 100-percent working interest to explore Block 27. Exploratory activities are currently underway. The block has potential for the discovery of both oil and natural gas. Like Saudi Arabia there is a growing domestic market for gas for industrial development and power generation.

Qatar: Our success in Qatar with large redevelopment projects, that feature the application of new waterflooding and reservoir characterization techniques, has successfully reversed nearly 25 years of declining production. When Occidental took over the operation of the Idd el Shargi North Dome in 1994, production had fallen from a peak of 50,000 barrels per day in 1970 to below 20,000 barrels. With the application of advanced drilling systems and new technologies, gross production soon rose above 100,000 barrels per day, peaking at 138,000 barrels.

By nearly tripling previous peak production, Occidental established a reputation as one of the world's premier companies in enhancing recovery from mature fields, and opened the door to new opportunities in Qatar and other parts of the Middle East.

In 1998, the Qatari government awarded Occidental a production sharing contract to develop the Idd El Shargi South Dome field, located 15 miles

from North Dome. Occidental is developing South Dome as a satellite field to optimize the capital efficiency of the two projects. Combined production from the two fields is currently about 42,000 barrels per day, net to Occidental.

Occidental also has implemented an innovative water-flooding program in the North Dome's Shuaiba Reservoir. The new waterflood is expected to recover an additional 110 million gross barrels of the remaining oil in place. Occidental's share of the incremental reserves is 42 million barrels. Occidental is currently evaluating a second-generation re-development project that has the potential of recovering an additional 200 million barrels.

We also are pursuing new exploration opportunities. We recently submitted a bid for Block 10, which is adjacent to the billion-barrel Al Shaheen Field, and we're evaluating other exploration blocks.

Yemen: In Yemen – like Oman – we've grown though the drill bit. Occidental holds a 38-percent interest in 230,000 barrels per day of production from the billion-barrel Masila field in Block 14. Masila was one the world's largest oil discoveries in the 1990s. Each year since its discovery, Masila's recoverable reserves and production have increased steadily. Today, Masila accounts for more than half of Yemen's total production. Occidental also holds a 20-percent interest in the East Shabwa field in Block 10 that is currently producing 27,000 gross barrels of oil per day.

In addition to our producing interests in Blocks 10 and 14, we have secured interest in 7 exploration blocks, encompassing nearly 15 million acres. We are the operator of Blocks 20 and 44 and have interests in 5 blocks along the border with Saudi Arabia. Our combined interests in these blocks expose us to nearly 25-percent of the entire country.

Occidental has a 75-percent working interest in Block 44 located in the Hadramaut province in central Yemen. Our geoscientists were drawn to the block because it's on trend with the East Shabwa and Masila fields.

Occidental holds a 50-percent working interest in Block 20 in the central part of the country. Like Block 44, Block 20 is in the midst of a hydrocarbon province where more than a billion barrels of oil and three trillion cubic feet of gas have been discovered.

We have a 40-percent working interest in Blocks 11, 12, 36, 54 and 59 in northeastern Yemen along the border with Saudi Arabia. These blocks are located in the largely under-explored southern portion of Rub al Khali desert. The high, remote sand dunes that characterize the southern Rub al Khali have made acquisition of high quality seismic very difficult.

We are committing considerable geoscience manpower in applying state-of-the-art technology to obtain high quality data we believe will unlock the door to large quantities of recoverable reserves.

Yemen provides Occidental with abundant opportunity to use its technical skills in various disciplines to create value. Yemen is our model for future exploration projects. We focus on assembling large acreage positions in countries in our core areas where there is minimal competition from the so-called super-majors and the entry costs are low. We structure contracts with multiple exit points and work commitments that are contingent on extensive geoscience data fully risked commercial potential.

Last year we completed a 3-D seismic program in Block 20. Preliminary analysis of these data was completed and plans are under way to begin drilling two exploratory wells in Block 20 next November. A 3-D seismic acquisition program will begin shortly in Block 44. Analysis of seismic data for Block 59 along the Saudi border and a test well is scheduled to begin drilling this month. We also will be drilling a series of step-out wells in Masila and East Shabwa to prove additional reserves. We expect to be very active in Yemen this year.

Abu Dhabi: Last March, the governments of the UAE and Qatar created the Dolphin Project by signing a 25-year agreement calling for delivery of 2 billion cubic feet per day of natural gas from Qatar's North Field to markets in the UAE by installing a 210-mile sub-sea pipeline.

The \$3.5 billion project is scheduled for start-up in early 2005. UAE officials have said that Dolphin will serve as a catalyst to stimulate the economies, not only of the UAE and Qatar, but the entire Arabian Gulf region. The project is being spearheaded by the UAE Offsets Group which was set up in 1992 with the charge of helping to diversify the UAE's economy and to reduce its dependence on oil.

When Dolphin was unveiled in March 1999, the Offsets Group held a 51-percent interest while private partners Enron and Total each had 24.5-percent interests. With Enron's withdrawal from the project last May, the Offsets Group took steps to find a replacement. This attracted great attention from a large number of global oil and gas companies. Several months ago, we were pleased to have been selected as one of five companies – including British Petroleum, Exxon, Shell and Conoco – that were short-listed for the project.

Technical meetings were held with the five companies in November and data rooms will be opened shortly. Recent published reports indicate that a new partner will be selected by early March.

Libya and Kuwait: Let me add a few words about Libya and Kuwait. As I said early in my remarks, Occidental's involvement with Libya dates from the mid-60s. In fact the company's early success in the international arena was due to its large Libyan oil discoveries. When the Reagan Administration imposed sanctions on the Libyan government in 1985, Occidental left the country but retained an interest in the assets we formerly operated. The Libyans would very much like us to return, and we are prepared to do so when sanctions are lifted.

Despite the US Senate's vote last year to extend the sanctions for another five years I am encouraged to see both the US and Libyan governments engaged in constructive dialogue aimed at resolving all outstanding issues. I believe there are people of good will on both sides who are committed to a normalizing of relations between the two countries. When that day arrives, Occidental is prepared to move quickly. This will be good for our shareholders – and good for the peoples of Libya and the US.

The much-anticipated opening of Kuwait's petroleum sector to foreign investment has been stalled in the Kuwaiti parliament. In the meantime, Occidental has received official approval to conduct business in Kuwait when parliament does act. We have a number of proposals we are prepared to present to Kuwaiti officials when the opportunity arises.

Summary & Conclusion: While we expect the Middle East to play an increasingly important role in our future plans, our portfolio will continue to be dominated by our large core assets in the US. Our asset mix provides balance and safety for investors. Our secure dividend of one dollar per share

is very competitive relative to our peers in the oil and gas industry and compares favorably with the average yield for large- and mid-cap companies on the S&P 500.

Because of the financial strength and flexibility that is a product of our restructuring, Occidental is in a much stronger position to capitalize on our fundamental strengths in the Middle East than we were four years ago. We used the strong energy environment to strengthen the company by improving our balance sheet and our returns on equity and capital employed. Our balance sheet is the strongest it's been in nearly two decades.

We're confident that our financial strength and discipline and nearly four decades of operational experience in the Middle East will serve as a cornerstone for growth strategy in this hydrocarbon-rich region. At Occidental, we see a future characterized by long and mutually beneficial partnerships with leading oil producing nations of the Middle East. We are confident because we've done it before.

We've done it through the drill bit – by working with local and national oil companies to find and prove new reserves.

We've done it by introducing industry-leading technology to substantially enhance production in mature and declining fields.

And we've done it by partnering with national oil companies to help their governments diversify their economies – by bringing new ideas, new resources, and new technologies to help them achieve their goals.

The Middle East has been good for Occidental and for our shareholders. The Saudi Arabia gas project is the first of several new projects we expect to land in the Middle East over the next few years. Key Middle East oil-producing countries will remain partners of the US – and of Occidental – for many years to come.

Thank you.