The Petroleum Industry Act and the Nigerian Economy

A Case of Too Little Too Late?

September 2021

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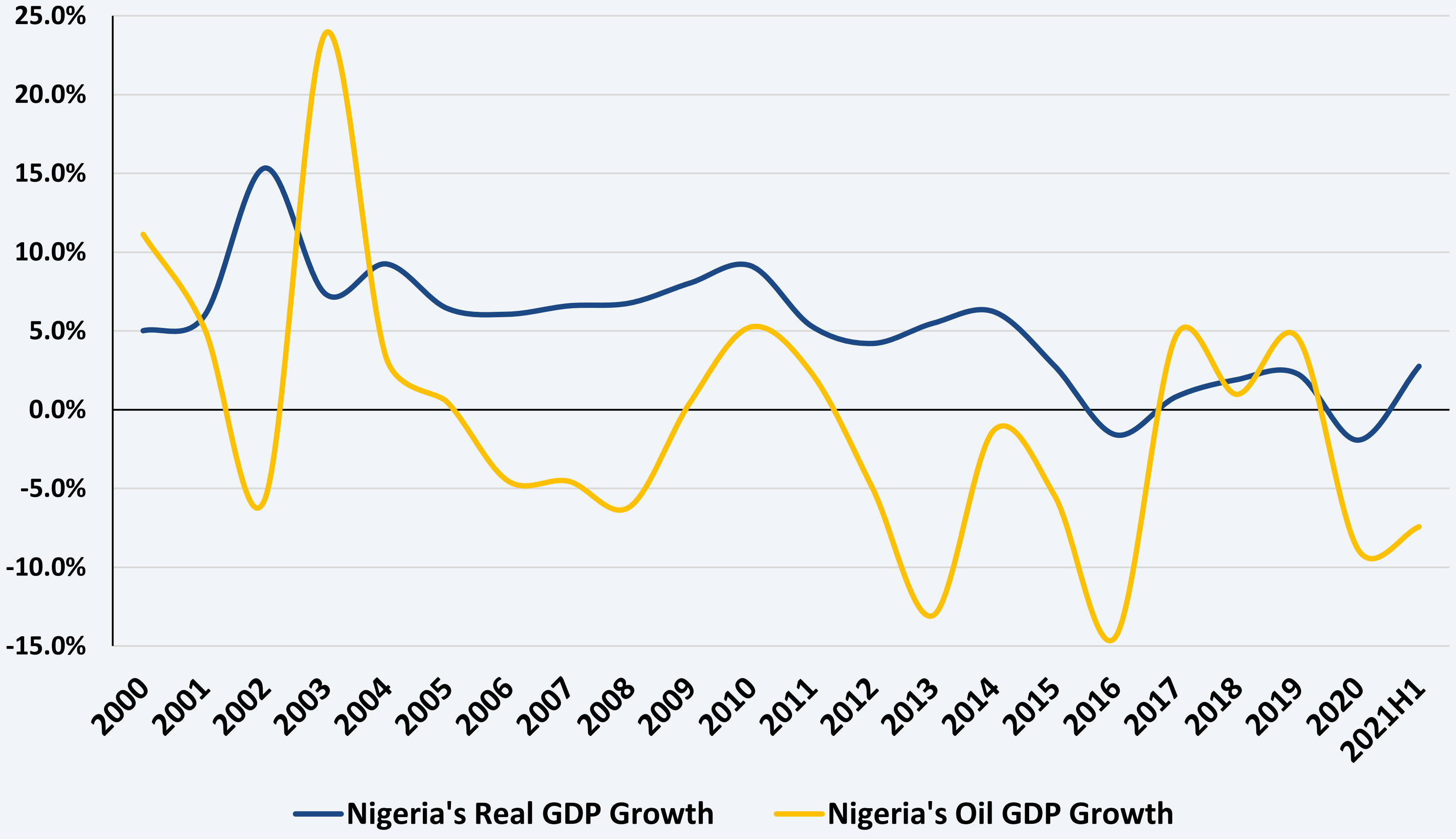
SECTION 01

Performance of Nigeria's Oil & Gas Industry

Nigeria's Oil & Gas Industry has been instrumental in the development of the economy

Nigeria's Real GDP Growth and Oil GDP Growth

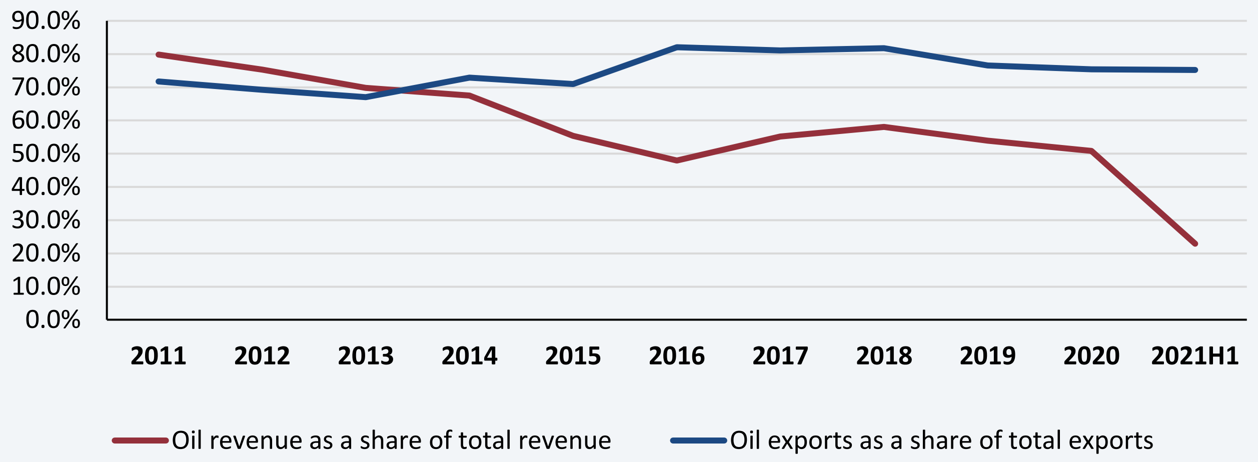


- Since the 1970s, crude oil has been the major driver of Nigeria's economic performance.
- On several occasions, periods of high economic growth have been associated with oil booms, while economic recessions have been caused by a decline in the price of crude oil.
- In the last two decades, the performance of the sector has been volatile mainly due to price fluctuations and challenges with oil production. This has translated into unstable GDP growth trajectory for Nigeria.
- Heavy reliance on crude oil and poor governance have also led to the slow development of the non-oil sector.
- Notwithstanding, the oil and gas sector, particularly natural gas, holds a huge prospect in positively impacting the Nigerian economy.

Data Source: Central Bank of Nigeria and National Bureau of Statistics

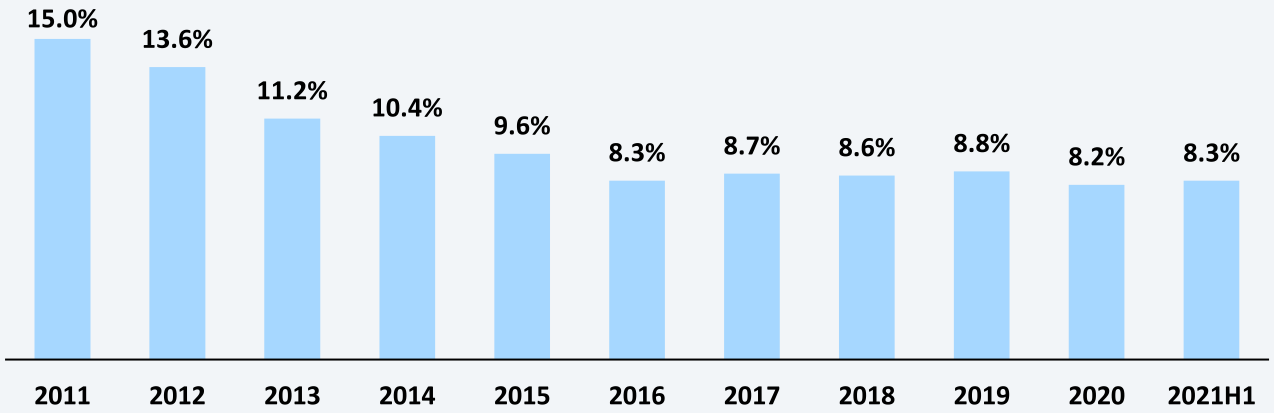
Nigeria's Oil & Gas Industry has been instrumental in the development of the economy…

Share of Oil Revenue and Oil Exports



Note: 2021H1 data for Oil revenue/total revenue covers the period Jan - May 2021

Nigeria's Oil GDP as a share of total GDP

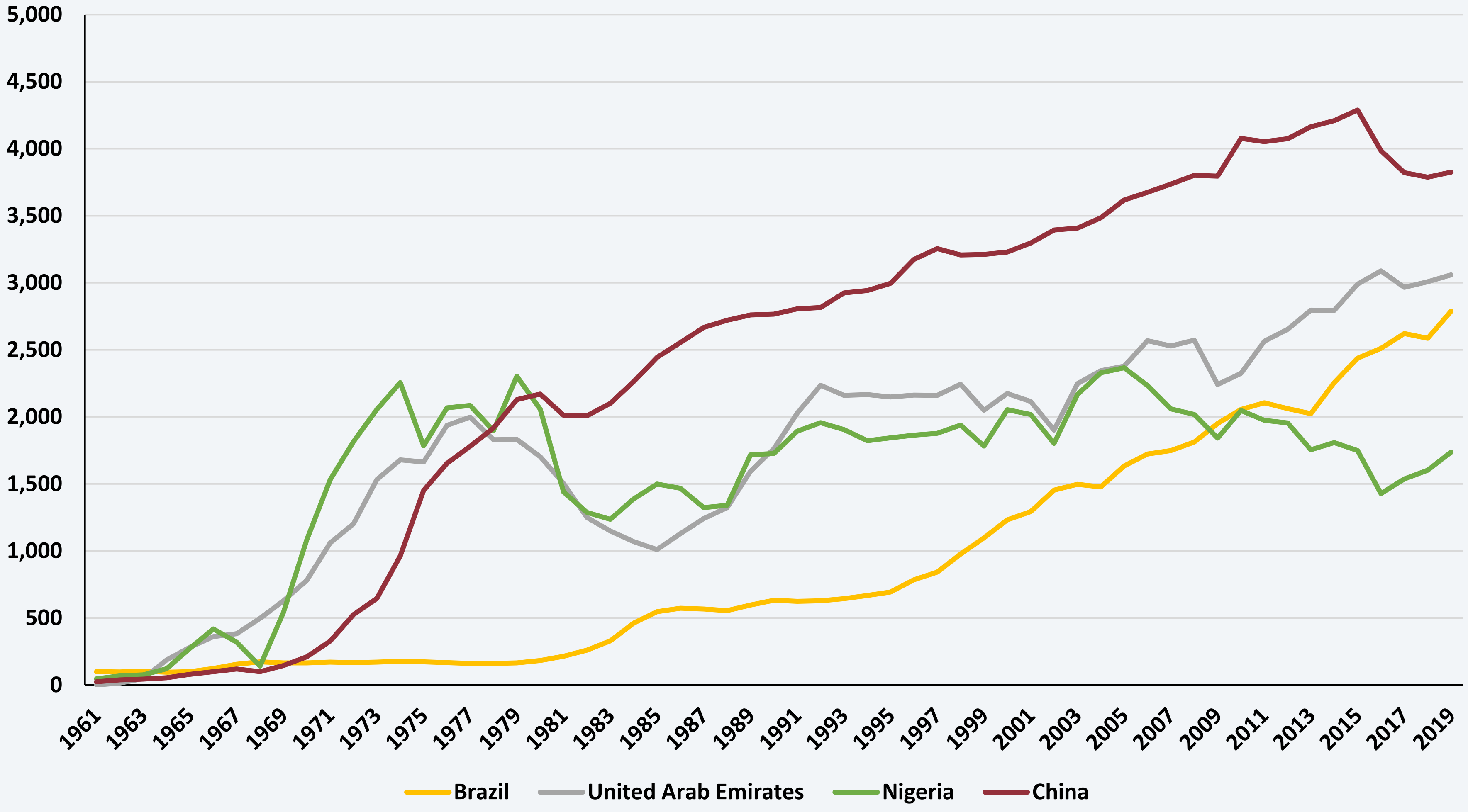


- The share of crude oil in government revenue has been declining since 2011 due to a number of factors:
  - Declining oil revenue as a result of lower oil prices.
  - Improvement in non-oil revenue
- Despite this trend, oil still accounts for over 70% of Nigeria's export earnings.
- Although the oil sector accounts for about 8% of Nigeria's real GDP, the sector is instrumental in shaping overall direction of the economy due to its linkage with government revenue, external reserves and foreign exchange.
- To finance development, Nigeria will need a combination of oil and non-oil revenue, development finance, and more importantly, private capital. In addition, Nigeria will need to unlock significant revenue from the gas sector.

Data Source: Central Bank of Nigeria, National Bureau of Statistics, Ministry of Budget, Finance and National Planning

…but is Nigeria really getting the most from its oil and gas industry?

Crude oil production by country (1,000 b/d)



- Nigeria's oil production has been largely unstable for decades.
- Remarkable growth in output was recorded in the early 1970s and early 2000s.
- In the last 10 years prior to COVID-19, Nigeria's crude oil production declined by an average of 0.2%.
- With COVID-19, oil production in Nigeria dipped to 1.6mbpd in 2020Q4 and 2.1mbpd in 2021Q1 due to OPEC cuts.
- Nigeria has not significantly improved production relative to countries such as China and Brazil.

Data Source: OPEC

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Is Nigeria really getting the most from its oil and gas industry?

Nigeria's Oil production per capita is low

- With an annual crude production per capita of 3.1 barrels, Nigeria is not producing enough crude oil when compared with major oil-producing countries.

Refineries have operated below optimal levels for decades

- For several decades, Nigeria has relied on importation to meet local demand of petroleum products due to the poor state of local refineries and subsidies.

Nigeria's Gas asset is largely unexplored

- According to the Department of Petroleum Resources (DPR), Nigeria has over 206.53 trillion cubic feet (TCF) of proven gas deposit but most of it remains untapped.

State owned Oil Company declares losses

- The NNPC, Nigeria's national oil company has faced severe challenges in meeting its quota in several JV agreement. The company declared a profit of N287 billion in 2020, for the first time in several years.

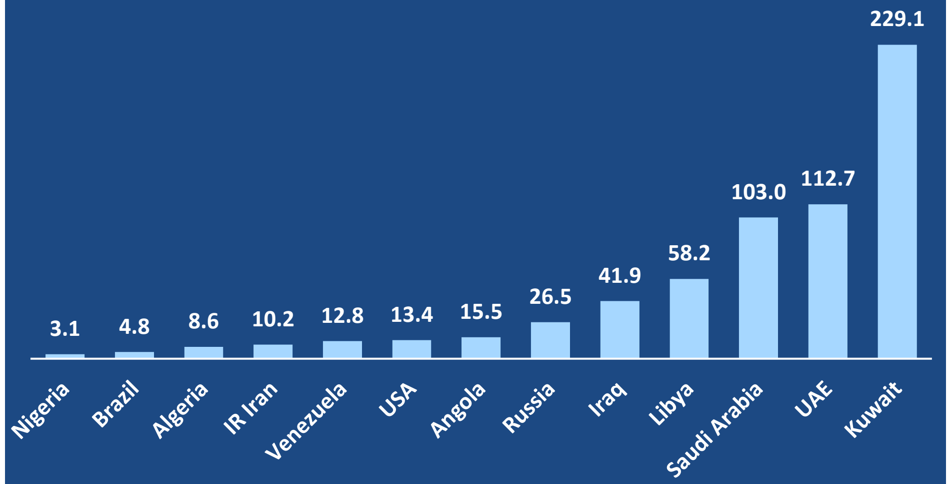
Environmental Pollution is prevalent

- On the social front, oil spillage and flaring of gas have resulted in severe environmental pollution in oil producing areas, destroying means of livelihoods for inhabitants in these areas.

Is Nigeria an Oil Rich Country?

Nigeria's oil production per person is the lowest among OPEC countries at 3.1 barrels per year. This is despite having over 41 billion barrels of crude oil reserves untapped. Even some oil producing countries with larger population than Nigeria like the USA and Brazil, have higher oil production per capita.

Annual oil production per person (barrels)



The major reason why crude oil "appears" to be important in Nigeria is because of the low level of development of the non-oil sector, especially in terms of contribution to government revenue, exports and reserve accretion.

Data Source: NNPC, World Bank WDI and OPEC

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From Petroleum Industry Bill (PIB) to Petroleum Industry Act (PIA)

Previous efforts to develop a holistic framework for the Industry

Key timelines for the PIA

April 2000
Former President Olusegun Obasanjo inaugurated the Oil & Gas Reform Committee (OGRC).

June 2005
The OGRC developed a National Oil & Gas Policy (NOGP) and the Oil & Gas Implementation Committee (OGIC) was set up.

Sept. 2007
Late President Umaru Yar'Adua, approved the NOGP and reconstituted the OGIC to implement the NOGP recommendations.

Sept. 2008
A Petroleum Industry Bill (PIB) was presented to the 6th National Assembly.

Jan. 2012
Former President Goodluck Jonathan constituted a task force to evaluate the PIB.

2013
The National Assembly concludes public hearing on the PIB.

2014
A revised version of PIB was re-presented to the National Assembly.

2016
The PIB was split into four separate bills- the Governance Bill (PIGB)*, Fiscal Bill (PIFB), Administration Bill (PIAB), and Petroleum Host And Impacted Community Bill (PHICB).

April 2016
The Petroleum Industry Governance Bill (PIGB) was presented to the National Assembly.

Mar. 2018
The two Chambers of the National Assembly harmonized and passed the *PIGB.

July 2018
The *PIGB was transmitted to the President for assent but assent was declined on the grounds of constitutional and legal inadequacies.

2020
The four separate bills, the PIGB*, the PIFB*, the PIAB* and the PHICB* were later re-introduced as a consolidated Petroleum Industry Bill.

July 2021
The two Chambers of the National Assembly passed the Petroleum Industry Bill.

Aug.2021
President Muhammadu Buhari signed the Petroleum Industry Bill into law.

***Note**
PIGB: Petroleum Industry Governance Bill; PIFB: Petroleum Industry Fiscal Bill; PIAB: Petroleum Industry Administration Bill; PHICB: Petroleum Host and Impacted Community Bill.

The PIA – A Case of Too Little Too Late?

The world is transiting to cleaner energy…

- The harsh reality facing Nigeria and other African oil producers, such as Angola and Ghana, is that the big multinational oil companies are moving away from oil and gas and investing more money in renewables.
- This trend is certain to accelerate as pressure intensifies on the oil majors, both from shareholders and external activists, to "go greener".
- Commercial banks, globally, are having to embrace the energy transition. Nigeria, which has seen oil and condensate production fall steadily over the past decade due to under-investment, may pay a heavy price for its lack of decisiveness in getting the bill over the finish line.
- Even with the PIA in place, there is a possibility that proven oil and gas reserves will become stranded. A litmus test will be Shell's on-going process to sell the remaining 19 onshore and shallow-water licences that it operates in the SPDC consortium with Eni and Total, in the coming years.
- Other majors such as ExxonMobil and Chevron are also looking to reduce their upstream portfolios in Nigeria. But finding buyers won't be so easy in this market. Nigerian independents that have paid billions of dollars for SPDC acreage over the past decade lack the majors' deep pockets and will be more cautious.

Renewable energy is the fastest-growing energy source globally. Renewables made up 26.2 percent of global electricity generation in 2018. This is expected to rise to 45 percent by 2040. Most of the increase will come from solar, wind, and hydropower.

Data Source: Center for Climate and Energy Solutions

The PIA – A Case of Too Little Too Late?

…but there are several reasons to be optimistic

1. *The PIA reflects a desire to bring more transparency to the petroleum industry.*

2. *The PIA lays down a new fiscal regime for the upstream sector that will reduce the tax burden on onshore and shallow water projects and, it is hoped, will act as a spur for greater investment.*

3. *Indigenous companies which are now the leading players in onshore/shallow water will benefit from the provisions of the Act. Nigerian companies can buy infrastructure, such as pipelines and refineries, and play an active role in the country's regeneration. There is no lack of entrepreneurial talent in Nigeria, but there remains a deep lack of confidence in how the system functions. On the surface, the PIA helps to address this.*

4. *The PIA also promises several institutional reforms which will improve efficiency and attract investments in the long run.*

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Why the Petroleum Industry Act?

Institutional Reforms

To create a governance system for transparent, accountable and conducive management of the petroleum industry.

Improve Administration

To expand the capacity of the petroleum industry, promote fair and commercial competitiveness of the industry and liberalize the downstream segment.

Industry Fiscal Framework

To expand the capacity of the petroleum industry to enhance revenue to the government through a clear and dynamic set of rules.

Host Community Development

To bring sustainable prosperity and direct socio-economic benefits to the host communities of petroleum facilities and enhance harmonious co-existence.

Propel Petroleum Industry Growth

Provide institutional, legal, competitive, and commercial framework for a conducive environment for the advancement of the oil and gas sector in Nigeria for the benefit of the citizen.

Analysts Views on the PIA and the Oil & Gas Industry

Crude oil has played a major role in Nigeria's development history. The oil and gas sector may account for about 8% of Nigeria's GDP but it contributes significantly to export earnings and reserves accretion. The fact that Nigeria's economic growth trajectory is closely linked with the performance of the sector suggests that the country is yet to break from its heavy dependence on crude oil.

The PIA has long been overdue. The absence of a holistic industry legislation has held the industry backward, resulting in loss of revenue and limited inflows of investment into the oil and gas sector. The passage of the PIA brings a lot of relief and has the potential to unlock new opportunities in the sector.

Unfortunately, the PIA comes at a time when the world is looking towards renewable energy. Renewable energy is the fastest-growing energy source globally and many of the oil majors are under pressure by their investors, governments and non-governmental organisations to reduce emissions. In addition, many of the international oil companies are divesting their investments in Nigeria. These twin challenges could serve as setbacks in the implementation of the Act.

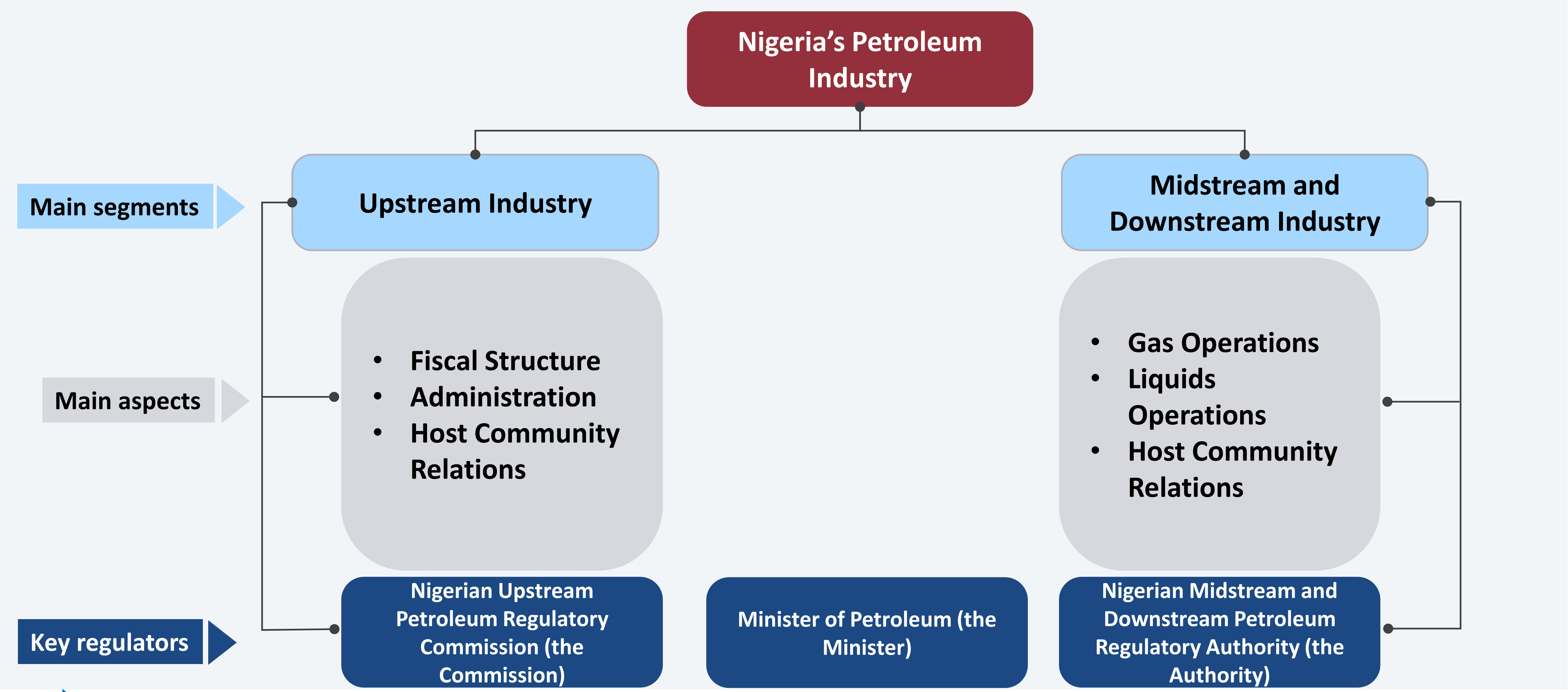
Notwithstanding the challenges, we are quite optimistic of the opportunities that the PIA presents. The opportunities, however, can only be realised with proper implementation of the provisions of the Act. Already, the government has instituted a steering committee on implementation. The government will also need to develop a comprehensive oil and gas policy, ensure alignment of government ministries and agencies and pursue accountability and transparency in the implementation of the Act and other associated policies.

The PIA: 5 Key Focus Areas

Our Focus on the Petroleum Industry Act (PIA) covers five key areas

1. **Nigeria's Oil & Gas Industry Administration**
2. Unbundling of the NNPC
3. Industry Fiscal Structure
4. The Host Community Development Fund
5. The Gas Industry

1. The PIA – Industry and Regulatory Structure



The PIA – Key Additions

INSTITUTIONS

Nigerian Upstream Petroleum Regulatory Commission (the Commission)	Regulate the upstream petroleum operations including technical, operational and commercial activities.
Nigerian Mainstream and Downstream Petroleum Regulatory Authority (the Authority)	Regulate the midstream and downstream petroleum operations including technical, operational and commercial activities.
Midstream and Downstream Infrastructure Fund	Develop plans for investment in infrastructural development for propelling the gas industry and increase the consumption of gas in Nigeria
Nigerian National Petroleum Company Limited	Carry out petroleum operations on a commercial basis comparable to private companies carrying out similar activities in the interest of the government.
Host Community Development Trust	To be overseen by the Commission or Authority as the case maybe to set aside funds for the development of the host community.
Board of Trustees Host Communities Development Trusts	To manage the Host Community Development Trust to determine the use of funds accruing to the Trust.
Host Communities Advisory Committee	Advise the management committee on activities and articulate development project for the improvement of the host communities.

The PIA emphasizes regulatory guidelines for the Industry

- The Act makes provision for some regulatory guidelines which spell out the responsibility of the regulators.
  - The PIA provides that the Commission shall be responsible for granting of petroleum exploration, prospecting and mining licenses and leases on a fair, transparent and competitive bidding process based on guidelines issued by the Commission.
  - The Minister may on the recommendation of the Commission, grant a petroleum prospecting or petroleum mining lease to a winner bidder. This is subject to his approval within 90 days after the application for license have been filed, after which the license is assumed approved.
  - A holder of petroleum prospecting license or petroleum mining lease shall pay to the government royalties, fees, rent and production or profit shares in the amount and time as prescribed in the license or lease made by the Commission.
  - The supply of crude oil and condensates for the domestic market shall be on a willing supplier and willing buyer basis.
  - An operator that flares or vents natural gas commits an offence under this Act and is liable to a fine prescribed by the Commission, and the Commission shall have the right to take, free of charge, natural gas that is destined for flaring at the flare-stack.

The Minister wields powers..

The Minister of Petroleum is granted the power to formulate, monitor, administer government policy and exercise general supervision of the petroleum industry. The Minister is responsible for the general supervision of the Commission and the Authority and appointments to their Boards are made by the President subject to confirmation by the Senate.

The PIA emphasizes regulatory guidelines for the Industry

- Furthermore, the Act defines offences and penalties concerning the operations in the industries, and gives the Commission and the Authority the right to apportion penalties in an order made in the Act.
- The PIA provides for licensees and lessees to keep Decommissioning and Abandonment Fund in an unaffiliated account accessible to the Commission or the Authority in the event of abandoning an oil facility.
- Alongside these specific guidelines, the PIA makes provision for policy changes that will impact the industry. The Commission or the Authority shall involve stakeholders' consultation in the process of making policy and regulatory changes.
- If for any reason the Commission and the Authority have to make policy interventions without the stakeholders' consultation, such intervention shall be valid for not more than one year.

Legality of Institutions and Repealed Laws

Some key provisions of the Act are as follows:

- The provisions of the Public Officers Protection Act shall apply in relation to any suit instituted against the Commission or the Authority and their personnel.

- A suit shall not commence against the Commission or the Authority or any of the personnel before the period of one month written notice of intension to commence a suit is served.

- Subject to the 1999 Constitution of the Federal Republic of Nigeria, where the provisions of any laws except the Nigeria Oil and Gas Industry Content Development Act are inconsistent with the provisions of this Act, the provisions of this Act prevail to the extent of the inconsistency.

- The Commission will take over the functions of the Department of Petroleum Resources (DPR) and the NNPC's National Petroleum Investment Management Services (NAPIMS) and the Authority will take over the functions of the PPPRA.

- Among the already enacted laws repealed by the PIA Include:
  - Associated Gas Reinjection Act, 1979. Cap. A25. Law of the Federation of Nigeria, 2004, and its Amendments;
  - Hydrocarbon Oil Refineries Act No. 17 of 1965, Cap. H5, Laws of the Federation of Nigeria, 2004;
  - Motor Spirits (Returns) Act, Cap. M20, Laws of the Federation of Nigeria, 2004;
  - Nigerian National Petroleum Corporation Act (NNPC) 1977 No. 33, Cap. N123, Laws of the Federation of Nigeria, 2004;
  - Petroleum Product Pricing Regulatory Agency (Establishment) Act No.8. 2003.

The PIA Repeals PPPRA Act and PEF; albeit Under-recovery is Likely to Stay

- In the PIA, issues around Petroleum Equalization Fund (PEF) and Petroleum Products Pricing Regulatory Agency (PPPRA) are looking to be discontinued.
- Recall that PEF came as a result of pipeline vandalism across the country and the resulting loss of petroleum products, which led to petroleum products being transported around the country mainly by road.
- Consequently, petroleum products have been sold at different (higher) prices in many parts of the country, with the price differential stemming from transportation costs. This has been more pronounced in the Northern states and the less built-up areas of the country which are far from the coastal areas.
- In response to this imbalance in prices, the Petroleum Equalisation Fund (PEF) was established in 1975. The PEF is funded by the net surplus revenue from petroleum marketers. A transportation cost of N2.75/litre is built into the pricing template of PMS by the PPPRA.
- In effect, consumers in regions close to the coast subsidise those away from the coast. The price uniformity is achieved by reimbursing a marketer's transportation cost based on the distance between depots and the filling stations.

Analysts Views on Under-recovery

- **That said, no provision in the Act suggests when the downstream sector will be fully deregulated.**
- **In fact, we understand that c.N900bn has already been earmarked to fund petrol subsidy over 2022E based on the provision of the 2022-24 MTEF.**
- **With debt service to revenue ratio expected to remain elevated, it is estimated that Nigeria will have to either raise debt to fund the 2022 subsidy payment or continue to take a significant FAAC haircut; the former is more likely.**
- **Following the above, we believe that under-recovery is likely to remain, at least in the medium term.**

	Under recovery (Nbn)	Oil price (US$/bbl.)	Retained revenue (Nbn)	Under-recovery (% of revenue)
2018	770	70.3	3,880	19.9%
2019	590	64.2	4,690	12.7%
2020	130	41.6	3,800	3.4%
2021*	1800	70.0	3,800	47.4%

Data Source: NNPC, Bloomberg, Budget Office, Team Analysis

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Our Discussion on the Petroleum Industry Act (PIA) covers five key areas

1. Nigeria's Oil & Gas Industry Administration
2. **Unbundling of the NNPC**
3. Industry Fiscal Structure
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2. The PIA: Unbundling of the NNPC, a positive development for the Industry

Separation of Commercial and Regulatory Function of NNPC

The Petroleum Industry Act proposes that the previously joint commercial and regulatory role solely carried out by the Nigerian National Petroleum Corporation (NNPC) will now be separated.

The NNPC Limited shall conduct petroleum operations commercially just like any other private company in the industry. It shall pay its fair share of royalties, fees, rents, taxes and other dues to the Government. It is required to declare dividends for shareholders after retaining 20% of profit for reinvestment.

Within six months from the commencement of the PIA, the Minister of Petroleum and the Minister of Finance shall incorporate the Nigerian National Petroleum Company Limited (NNPC Limited) under the existing Companies and Allied Matters Act (CAMA) in an effort to commercialize the current NNPC.

Ownership of all shares of NNPC Limited shall be vested in the Government at incorporation and held by the Ministry of Finance and Ministry of Petroleum in equal proportion which are not transferable unless approved by the government and National Economic Council.

The composition of NNPC Limited Board shall be based on CAMA and Article of Association of NNPC Limited. They shall discharge their responsibilities in accordance with the highest standard of the principles of corporate governance. Their appointment shall be by the President.

The Ministries (Finance and Petroleum) may increase the equity capital of NNPC Limited in consultation with the Government. Sales or transfer of shares shall be done equally by the Ministries.

The PIA: Unbundling of the NNPC, a positive development for the Industry

With the NNPC reforms, two key factors are imperative

- **First, the separation of the commercial and regulatory role of the NNPC could reduce government/political interference in the sector.** The PIA stated that the role of the minister will be general oversight and policy formulation. Precisely, the minister may grant or revoke leases and licenses only upon the recommendation of the Nigerian Upstream Regulatory Commission, rather than the absolute power currently.

- **Secondly, the incorporation of the NNPC sets the stage for an Initial Public Offering (IPO) of the group and subsequent listing on the stock exchange.** This development should increase the depth of the Nigerian equity capital market. The Group Managing Director of the NNPC noted that this could happen in 2024 given the various odds. It is imperative to highlight that there are only two upstream exposure in the domestic capital market – SEPLAT and OANDO. A third company will provide diversification opportunities, especially where varying internal risk specifics exist among listed names.

Broadly, this development is intended to enhance governance, accountability, and transparency; and establish a framework for a creation of a commercially oriented and profit-driven national petroleum company.

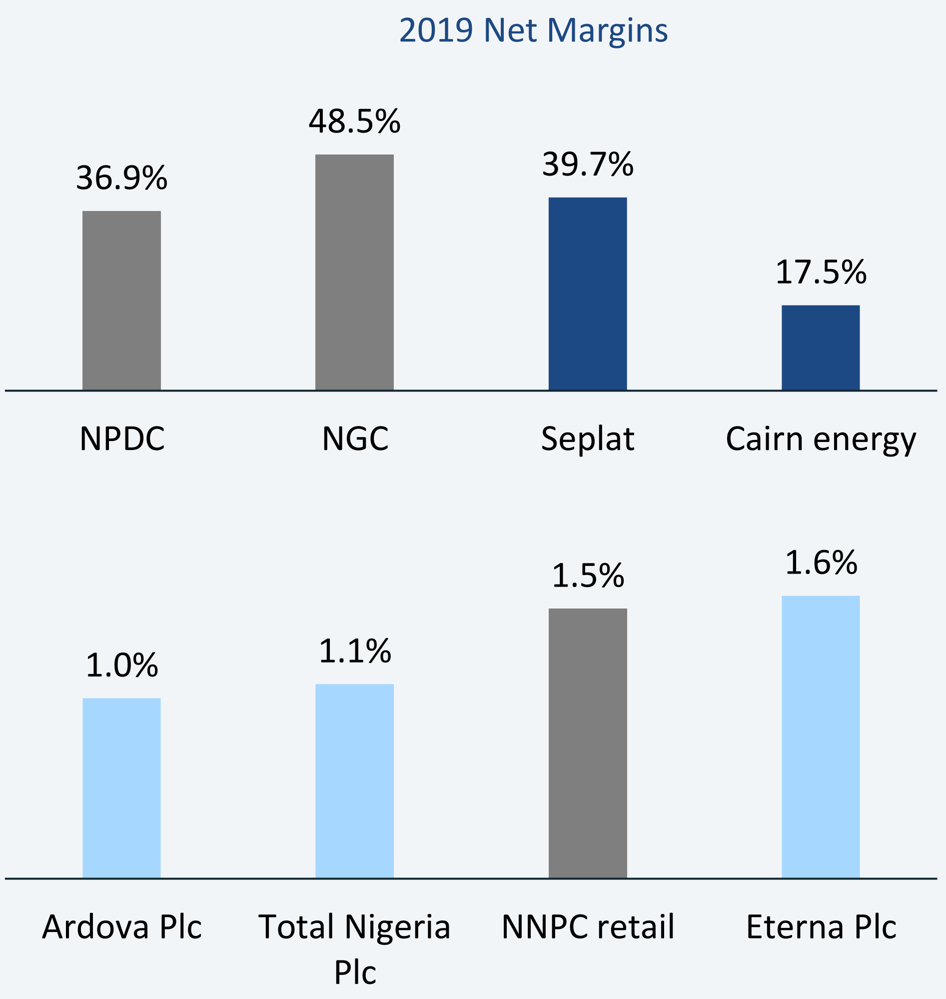
Listing the NNPC Limited on the NGX like Saudi ARAMCO, Rosneft and Gazprom in Russia and Gazprom in Germany could lead to:

- access to the capital market to source for fund independent of the government;
- open doors for more investment in the company and the oil and gas sector as a whole.
- increase management transparency of the company which is a requirement for listing;

The PIA: Unbundling the Structure of NNPC Limited Could be Value Additive

Unbundling of the NNPC could support better-performing companies in the group

- An unbundling of the current structure of the NNPC as proposed in the PIA possesses some value.
- Insights from the 2019 audited financial statement of the NNPC revealed that the N1.7bn loss after tax recorded was driven mostly by the moribund refineries since the financial statement is still consolidated.
- This, thereby, drags the better-performing companies through the mud in the period.
- Companies such as the NGC, NPDC, and NNPC Retail Limited boast of net margins that compare favorably with listed private companies (See chart).
- We believe a dissociation or concession from the margin dilutive business within the group could set up the new NNPC for a great IPO candidate on the domestic equity market.



Data Source: NNPC, Company financials, Team Analysis

The PIA: Unbundling the Structure of NNPC Limited Could be Value Additive

Market Capitalisation of select oil & gas companies

	Mkt Cap (mn USD)	Forward EV/Revenue
Saudi Arabian Oil Co	1,871,700	5.23
Exxon Mobil Corp	230,073	1.04
Chevron Corp	187,029	1.44
Royal Dutch Shell Plc-A Shs	153,705	0.70
Petrochina Co Ltd-H	138,827	0.56
Totalenergies Se	116,373	0.78
BP Plc	82,359	0.68
Enbridge Inc	81,703	3.90
China Petroleum, Chemical	79,919	0.30
Conocophillips	74,158	2.13
Petrobras - Petroleo Bras-Pr	64,220	1.39
China Shenhua Energy Co-H	63,480	1.46
Eni Spa	45,262	0.80
Cnooc Ltd	44,385	1.09

The listing of the NNPC will significantly add to the current market capitalization of the local equity bourse of N20.5tn.

NNPC Revenue	
NNPC Revenue (mn N) - 2019	4,634,229
Exchange rate	410
NNPC Revenue (mn USD)	11,303

Data Source: Industry Sources, NNPC

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3: The New Fiscal Structure aims to attract investment into the Industry

- The purpose of the Petroleum Industry Fiscal Framework is to provide a progressive fiscal framework that encourages a profitable business environment for investment in the Nigerian Petroleum Industry. It is also to expand the revenue base of the federal government based on the principles of clarity, dynamism, equity, transparency and fiscal rules.

- The Petroleum Industry Act provides the following:

  - The Act notes that all monies in the form of taxes, royalties, production shares, profit shares, signature bonuses, production bonuses, rent, fees, fines, and other levies shall be transferred to the Federation Account in timely manner.

  - The administration and collection of government revenue in the industry shall be the function of government institutions as follows:
    - The petroleum profit tax has been split into the ***Hydrocarbon Tax (HT)*** *and* ***Companies Income Tax (CIT)*** to be collected by the Federal Inland Revenue Service (the Service). The Service is also empowered to collect the Tertiary Education Tax in the industry.
    - The Commission is empowered to collect royalties, signature bonus, rent, production shares and related payments.
    - The Authority is empowered to collect gas flaring penalty arising from the midstream operations and its enforcements under this Act.

  - The hydrocarbon tax applies to crude oil as well as field condensate and liquid natural gas derived from associated gas and produced in the field upstream.

  - The Act provides that the chargeable tax shall be ***30%*** of profit from crude oil for petroleum mining lease and ***15%*** of profit from crude oil onshore and shallow water for petroleum prospecting licenses. It also provides for ***30%*** in Companies Income Tax and ***2%*** Education Tax which has become non tax deductible.

Fiscal Structure: Old Framework vs New Framework

Old Fiscal Framework

Depth	Production Sharing Contracts (%)	Concessions	Additional Provision
Oil (Taxes)			
Onshore	50	85% PPT	65.75% for the first five years
Shallow water (c.200m depth)	50	85% PPT	65.75% for the first five years
Offshore Deepwater (>200m depth)	50	-	-
Frontier Basins	-	-	-
Oil (Royalties)			
Onshore		25.00%	-
Shallow water (c.200m depth)		Between 16.5% - 18.5%	-
Offshore deepwater (>200m depth)		Between 10.0% - 12.5%	-
Frontier Basins		7.50%	-
Gas			
Taxes	-	30% CIT	-
Royalties	-	7.0% of revenues	-

New Fiscal Framework

Depth	Converted Leases	New Leases	Additional Provision
Oil (Taxes)			
Onshore	HT: 30% + CIT: 30%	HT: 15% + CIT: 30%	-
Shallow water (c.200m depth)	HT: 30% + CIT: 30%	HT: 15% + CIT: 30%	-
Offshore Deepwater (>200m depth)	CIT: 30%	-	-
Frontier Basins	CIT: 30%	-	-
Oil (Royalties)			
Onshore		15.00%	5.0-7.5% applies to <10kbpd
Shallow water (c.200m depth)		12.50%	5.0-7.5% applies to <10kbpd
Offshore deepwater (>200m depth)		7.50%	5.0% applies to <50kbpd
Frontier Basins		7.50%	7.50%
Gas			
Taxes	-	30% CIT	-
Royalties	-	5.0% of revenues	2.5% (natural gas produced & utilised in Nigeria)

Data Source: Petroleum Industry Act

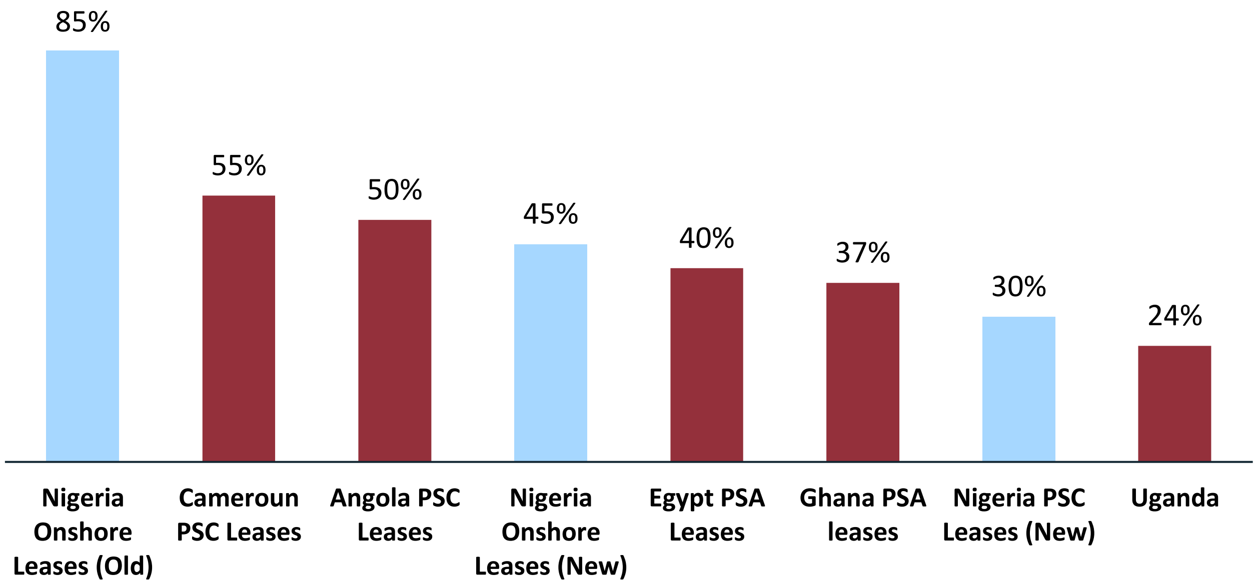
Fiscal Structure: Price-Based Royalty Could Offset Tax Reduction

- We like that the Petroleum Industry Act (PIA) focuses on a framework that consolidates an enhanced revenue-generating capacity for the government and improved sector competitiveness when compared to peer African countries such as Angola, Ghana, and Mozambique.
- Upon implementation, the Act will reduce royalty and taxes, a move that dovetails neatly with the age-long aspiration of the International Oil Companies (IOCs).
- However, what appears as counterintuitive is the provision for price-based royalties, which should raise the government's income when oil prices are robust; but at the expense of upstream producers.
- Unlike in the past when taxes and royalties were ambiguous, upstream oil & gas companies now look to pay a fixed rate for hydrocarbon tax and companies income tax. Although we noted that offshore deepwater assets have been excluded from hydrocarbon tax, the current rate of 30% will apply to converted leases, while 15% will be exercised on new leases.
- **This will be in addition to a 30% CIT, translating to a cumulative tax of 60% and 45% for converted and new leases, respectively**.

Fiscal Structure: Price-Based Royalty Could Offset Tax Reduction

- **The reduction in fixed-rate royalties would have been admirable, especially when viewed from the perspective of upstream operators.**
- **However, the PIA provides significant room for the government to rake in some benefit in an elevated oil price environment, due to the introduction of price-based royalties to all acreages.**
- **For instance, additional royalties of 5% will apply when the oil price is at US$100/bbl. It increases to 10% at US$150/bbl. oil prices.**
- **This appears counterintuitive to taxes and royalties reduction and can somewhat complicate the fiscal structure as seen in the past.**

How Nigeria's taxes compare to African peers



Royalties payable on crude oil price

At US$100 per barrel	**5%**
At US$150 per barrel	**10%**

Data Source: Bloomberg, Team Analysis

Fiscal Structure: Frontier Exploration Fund (FEF)

- One topical aspect of the fiscal structure remains the creation of the Frontier Exploration Fund (FEF), which is targeted at funding the exploration of hydrocarbons in the inland basins.
- We understand that the fund will be financed by 10% of rents on petroleum prospecting licenses and petroleum mining leases, together with 30% of NNPC Limited's profit oil and profit gas.
- While the negative pass-through from the preceding is a possible reduction in the government revenue without any meaningful guarantee for future cash flows, we believe that redirecting such fund towards the monetization of 2P reserves would be a better use of scarce resources, rather than the new exploration.
- This is particularly important given the global shift away from carbon-intensive energy sources to renewable energy sources.

Our Discussion on the Petroleum Industry Act (PIA) covers five key areas

1. Nigeria's Oil & Gas Industry Administration
2. Unbundling of the NNPC
3. Industry Fiscal Structure
4. **The Host Community Development Fund**
5. The Gas Industry

4. Host Communities Development Trust: Justified Fright or Overblown Concern

- The Act states that the Commission or the Authority may make regulations with respect to host community development and develop grievance mechanism to resolve disputes between host communities and operators.
- Each host community development trust shall establish host community development trust fund. Each settlor, where applicable through the operator, shall make an annual contribution to the applicable host communities development trust fund of 3% of its annual operating expenditure of the preceding financial year in the upstream petroleum operations affecting the host communities.
- The funds of the host communities development trust created under this Act shall be exempted from taxation.
- The Act provides that 75% of the host communities development trust fund be disbursed for development projects in host communities; 20% to the reserves invested on behalf of the host communities; and an amount not exceeding 5% be used for administrative cost.

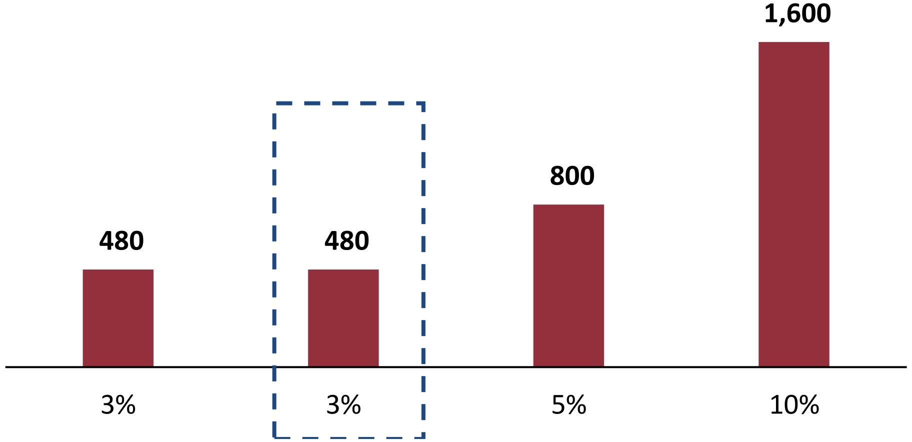
"Each settlor, where applicable through the operator, shall make an annual contribution to the applicable host communities development trust fund of an amount equal to 3% of its actual annual operating expenditure of the preceding financial year in the upstream petroleum operation affecting host communities …"

Host Communities Development Trust: Justified Fright or Overblown Concern

- The PIA provides 3.0% of actual operating expenditure in the preceding year to be allocated to the Host Community Development Trust (HDCT).

- We highlight that on the actual operating expenditure of US$16bn in 2020, allocation to HCDT can rise to about US$480mn, a sizeable sum in our view, and should help in securing peace in the oil-producing region of the federation.

HCDT vs. implied absolute amount (in mn US$)



- While we remain generally sanguine, we do not rule out implementation risk, especially when viewed from the perspective of the challenged Niger Delta Development Commission (NDDC).

- Beyond that, we imagine that a refusal of host communities to accept less than their 10% demand could resurrect agitations in the communities.

- To protect against any vulnerability and shocks, the Act provides that the Host community will now forfeit its entitlement to the extent of the cost of repairs due to vandalism, sabotage, or other civil unrest that results in damage to petroleum and designated facilities within the host community.

Data Source: Team Analysis

Our Discussion on the Petroleum Industry Act (PIA) covers five key areas

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5. The PIA and the Gas Industry

- With a proven gas deposit of over 206.53 trillion cubic feet (TCF), Nigeria appears to have a greater potential for gas than crude oil. Hence, the PIA made several provisions to develop the gas industry.

- Given the increasing campaign for cleaner energy, gas and related liquids have a strong positive outlook and the PIA makes several provisions to encourage investment, development and growth of the gas industry.

- Specifically, the Authority shall establish the Midstream and Downstream Gas Infrastructure Fund which is to be funded by 0.5% of wholesales price of petroleum products and natural gas sold in Nigeria.

- The Authority will make government equity investment in infrastructure development in the gas industry. It will also develop strategies to increase domestic consumption of gas and reduce or eliminate gas flaring in Nigeria.

- The PIA provides regulatory forbearance in terms of tax, rent, royalties and other remittance to the government. Also, the PIA provides for an additional 5-years tax holiday to be granted to investors in gas pipelines. This is to incentivize gas utilization in midstream petroleum operation and large scale gas utilization in the country.

- Furthermore, the provision of Frontier Basin Fund could be instrumental in the infrastructural development for the natural gas exploration and production.

Analysts Views on the PIA

The PIA provides a much-needed fiscal and legal framework for the oil and gas sector and allows the Nigerian National Petroleum Corporation (NNPC) to become a self-governing entity that could, at some stage, be privatised. Demonstrating a sense of urgency, the President has also approved a steering committee, chaired by the Minister of State for Petroleum, that has been tasked with implementing the PIA over a two-year period.

The PIA reflects a desire to bring more transparency to the industry. Investors will be reassured by the PIA's creation of two new regulatory agencies – the Nigerian Upstream Regulatory Commission and the Nigerian Midstream and Downstream Petroleum Regulatory Authority. The Commission will be a beefed-up version of the Department of Petroleum Resources and will have the right to award and revoke upstream licences subject to the approval of the ministry of petroleum. The Authority will oversee pipelines and refineries and ensure there is sufficient supply of oil and gas for an expanding domestic market. As Nigeria's three major refineries, all owned by NNPC, are operating at a fraction of their capacity, the NMPDRA faces a herculean challenge.

The unbundling of the NNPC holds great value for the country. However, the key unanswered question surrounding NNPC's future is what will happen to the liabilities of around US$11 billion owed to its joint venture partners, including funding shortfalls. According to the PIA, the old NNPC will transfer its assets and liabilities to NNPC Limited within 18 months, and it will be the job of the petroleum and finance ministries to decide what to do with them. This lack of clarity will concern NNPC's main creditors who are looking for some roadmap to get their money repaid. There is every possibility that NNPC's liabilities will become a political hot potato that will be passed around the various decision-making bodies, and left unresolved.

Nigeria's gas assets remain largely untapped. The PIA incentivises the development of these assets with forbearance on rent, royalties and 5 year tax holiday. We believe that a combination of these incentives and the opportunities that exist in the sector will steer the sector towards a new direction, albeit, at a slow pace given the political environment and the need to set up the relevant policy and institutional frameworks.

Business Opportunities Presented by the PIA

The PIA – Business Opportunities in the Oil & Gas Sector

Some Notes on Key Opportunities

- The PIA lays down a new fiscal regime for the upstream sector that will reduce the tax burden on onshore and shallow water projects.
- It is hoped that this will spur investment, particularly from Nigerian independents, which are now the leading players in onshore/shallow water as the majors continue to divest.
- The impact on the majors is minimal, as the bulk of their investments are in deepwater projects, which are governed by long-term production-sharing contracts with NNPC which have their own legal and commercial conditions.
- Any attempts by NNPC or the government to renegotiate the terms of these PSAs would meet stiff resistance, and tie the country up in multiple lawsuits.

The PIA – Business Opportunities in the Oil & Gas Sector

Some Notes on Key Opportunities

- Nigeria is unique in Africa for having a proliferation of indigenous oil companies that are keen to expand and build on their upstream expertise.
- These companies may end up being the main beneficiaries of the PIA, as foreign operators pull back and look to deploy their capital elsewhere.
- The main problem for the Nigerian indies is getting access to capital, so there will be a greater opportunity for Nigerian banks to support them with loans and other kinds of financing.
- There is also scope for Nigerian companies to buy into infrastructure, such as pipelines and refineries, and play an active role in the country's regeneration.
- There is no lack of entrepreneurial talent in Nigeria, but there remains a deep lack of confidence in how the system functions and can be manipulated by the politicians. On the surface, at least, the PIA helps to address this.

The PIA – Business Opportunities in the Oil & Gas Sector

	Business Opportunity	How Act enables opportunity
1.	*Frontier Exploration Fund*	Clause 9(4) of the PIA provides for the establishment of a Frontier Exploration Fund by the Nigerian Upstream Petroleum Regulatory Commission ("NUPRC" or the "Commission") which shall hold 30% of NNPC Limited's profit oil and profit gas. These funds shall be utilized towards carrying out development activities in frontier acreages, subject to appropriation by the National Assembly.
	Key opportunities for: Indigenous upstream players, Oil services firms, oil and gas consultants	
2.	*Midstream & Downstream*	Clause 317(8) states that the Authority may apply the Backward Integration Policy in the downstream petroleum sector to encourage investment in local refining. It further noted that pursuant to the above, licence to import any product shortfalls may be assigned to companies with active local refining licences or proven track records of international crude oil and petroleum products trading.
	Key opportunities for: local and international investors in the midstream sector, oil and gas consultants	
3.	*The Environmental Remediation Fund*	Clause 103 of the PIA provides for the establishment of the 'Environmental Remediation Fund' where a periodic financial contribution will be remitted for the rehabilitation or management of negative environmental impacts with respect to the license or lease. Size of the operations and environmental risk will determine the amount of the financial contribution. The financial contribution will be subject to audit by the licensee or lessee in accordance with the Authority's guidelines.
	Key opportunities for: host communities and MMEs, oil services firms, ESG consultants.	
4.	*Host Community Development Fund*	Clause 235 of the PIA requires the "settlor" who is the upstream player to incorporate a host communities development trust which it would contribute 3.0% of its preceding year's actual annual operating expenditure. The fund will be used to care for the interests of the host community. Other associated clauses included 240 – 247.
	Key opportunities for: host communities, construction industry, law firms.	

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The PIA – Business Opportunities: The Gas Industry Leads the Way

- The PIA incentivizes gas monetization in Nigeria, with gas royalties now reduced by 2 percentage points to 5.0%. Royalties on gas can be as low as 2.5% for natural gas production targeted at domestic market.

- This creates huge incentives for massive investment in gas business, since a significant share of power generation in Nigeria comes from gas.

- A combination of insufficient gas supply and inadequate infrastructure has contributed significantly to inadequate power supply in Nigeria. We believe that this structural demand prospect for gas will justify investment in the business.

- It is worth noting that Nigeria is a gas rich country given the huge gas reserves it boasts of. In addition, gas prices in Nigeria are decoupled from the volatility in the global oil market, because prices are pegged at US$2.5 per million standard cubic feet.

- Thus, we think there are ample opportunities for the upstream players to reallocate portfolios towards gas to extract more value.

The PIA – Business Opportunities: The Gas Industry Leads the Way

- We like that the FGN is also aware of this opportunity, following its declaration of 2021-2030 as a decade for gas.
- We recall that NNPC partly owns ANOH gas project through the Nigerian Gas Company (NGC). ANOH recently completed its debt and equity final investment decision of US$650mn, with the project now looking set to produce its first gas by 2022.
- In addition, NGC has also recently completed an FID on a US$3.6bn Integrated Gas Processing and Methanol Plant in Bayelsa, a project operated by the Brass Fertilizer Limited. All of these point to the opportunities in the Gas Industry.

- ***For the downstream industry,*** players in this space will likely adjust portfolios towards the lubricant business, where margin is attractive, relative to white products.
- That said, we think the fate of the downstream sector will continue to hang by the slimmest thread. Until the sector is completely deregulated, we believe the current industry structure will continue to squeeze profitability, and thus, deter new investment.

How Nigerian Downstream Players Compare to Peers

Company	Net Margin (%)
Eterna Plc	**1.6**
Total Nigeria Plc	**1.1**
Ardova Plc	**1.02**
Total Kenya Ltd	5.04
Total Petroleum Ghana Ltd	4.72
Engen Botswana	4.18
Total Cote D'Ivoire Sa	2.3
Vivo Energy Mauritius Ltd	2.05
Ghana Oil Co Ltd	1.91
Vivo Energy Cote D Ivoire	1.59
Shell Oman Marketing	0.7
Oman Oil Marketing Company	0.22
Average	**2.05**

Data Source: Industry Sources

Key Risks to watch out for

Investors in the oil and gas industry are likely to be cautious for the following reasons:

1. Environmental/Climate Change concerns

- The rapid pace of global energy transition towards low carbon-emitting and renewable sources could place a ceiling on the potential benefit that could accrue from the PIA, especially from the perspective of sector modernisation, transparency, and competitiveness when compared to oil-producing African countries.
- While we understand that a host of final investment decisions (FIDs) are still pending on several offshore projects that are expected to create an additional capacity of about 900kb/d, it is reasonable to assume that international oil-producing companies are not likely to rush to Nigeria, especially as ESG (Economic, Social, and Governance)-driven pressure from investors continues to drive their energy transition strategy.
- Although the reduction in taxes and an even clearer fiscal regime are welcome developments, these reductions may not induce huge fresh foreign investments into the oil and gas sector in Nigeria, mostly due to the undue ESG-driven paradigm imposed on IOCs.
- Since the oil & gas industry remains one of the top contributors to global emissions, environmental concerns, together with the resulting drive for energy transition, have taken center stage in recent times.

- Against this backdrop, exploration & production, and oilfield services businesses are now facing a dogged push for broader limits on carbon emissions, a connotation that could affect fresh investments across the board.

Asset	Buyer	Interest	Seller
OML 17	Heirs Holding	45%	Shell (30%), Total (10%) and ENI (5%)
OMLs 86 and 88	Conoil	40%	Chevron
SPDC	NA	100%	SPDC joint venture

- Several IOCs are now gradually divesting from Nigeria, especially from shallow water blocks.
- Shell Petroleum Development Company (SPDC) for instance, is looking to sell its Onshore Shallow Water assets since it no longer views it as core in its strategy, which is driven by the ESG pressure from its investors.

Data Source: Shell, TNOG, Conoil Disclosure

Investors in the oil and gas industry are likely to be cautious for the following reasons:

- Furthermore, a host of final investment decisions (FIDs) are still pending on several offshore projects. Beyond environmental concerns, these projects are likely to be delayed due to uncertainty regarding their commercial viability. It is estimated that these projects could create additional capacity of up to the tune of 900kb/d for Nigeria if the final investment decision is reached.

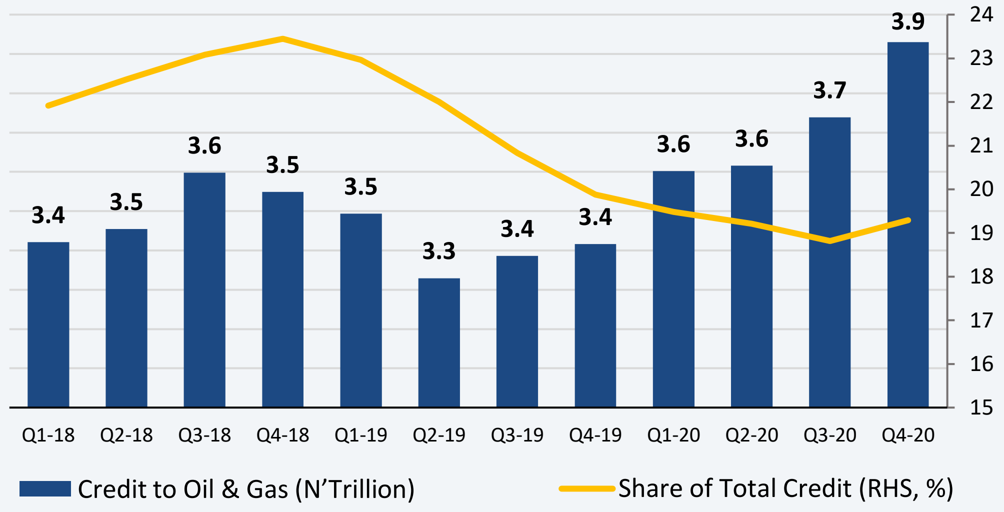
Project	Operator	Output	Depth	Estimated Output (kbpd)	FID
Bonga Southwest and Aparo	Shell	Liquid	Offshore Deepwater	225	No
Bonga North	Shell	Liquid	Offshore Deepwater	100	No
Zabazaba-Etan	Eni	Liquid	Offshore Deepwater	120	No
Bosi	ExxonMobil	Liquid	Offshore Deepwater	140	No
Satellite Field Development P.2	ExxonMobil	Liquid	Offshore Deepwater	80	No
Uge	ExxonMobil	Liquid	Offshore Deepwater	110	No
Nsiko	Chevron	Liquid	Offshore Deepwater	100	No

Data Source: US EIA, Team Analysis

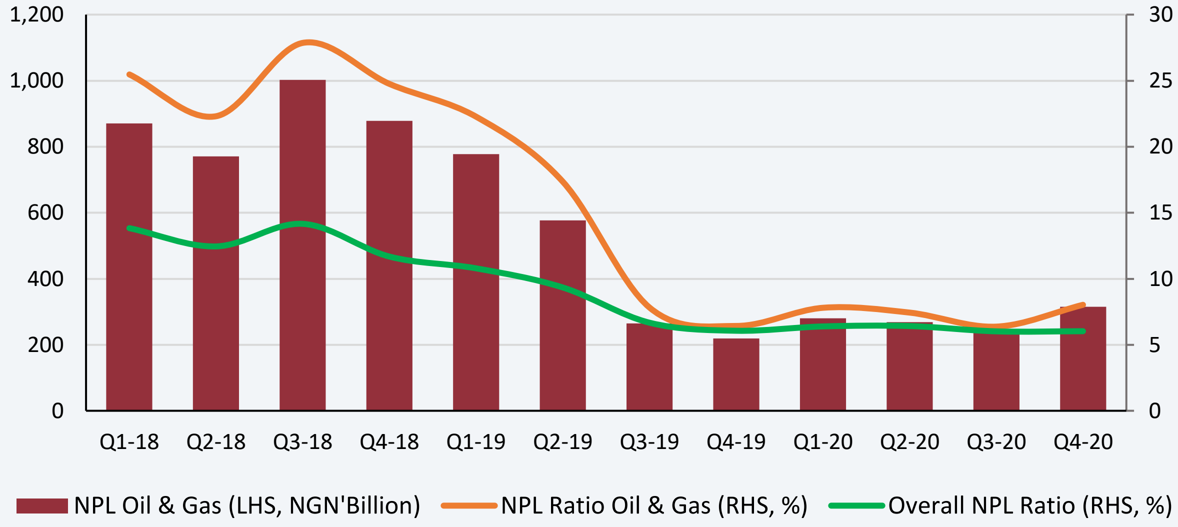
Investors in the oil and gas industry are likely to be cautious for the following reasons:

2. High exposure risk of commercial banks to the oil and gas sector

Banking Sector Credit to the Oil and Gas Sector



Non-performing Loans in the Oil and Gas Sector



- The oil and gas sector has been a major destination of banks' credit in Nigeria. The challenges associated with the sector in 2020 saw a declining trend in the share of oil and gas credit in total credit to the economy. Despite this, nominal credit to the sector increased. (See chart above).

- The sector remains instrumental in determining non-performing loans (NPL) in Nigeria. The total NPL of the sector in nominal terms as at the end of 2020 stood at N315.38 billion from N219.47 billion at the end of 2019. Therefore, NPL ratio was 8% in 2020.

- Despite the growth in credit to the sector over the past three years, the sector's NPL ratio remains relatively stable.

- With this in mind and following the signing of the PIA, there is room for the banking sector to expand position for expanding credit to the oil and gas sector.

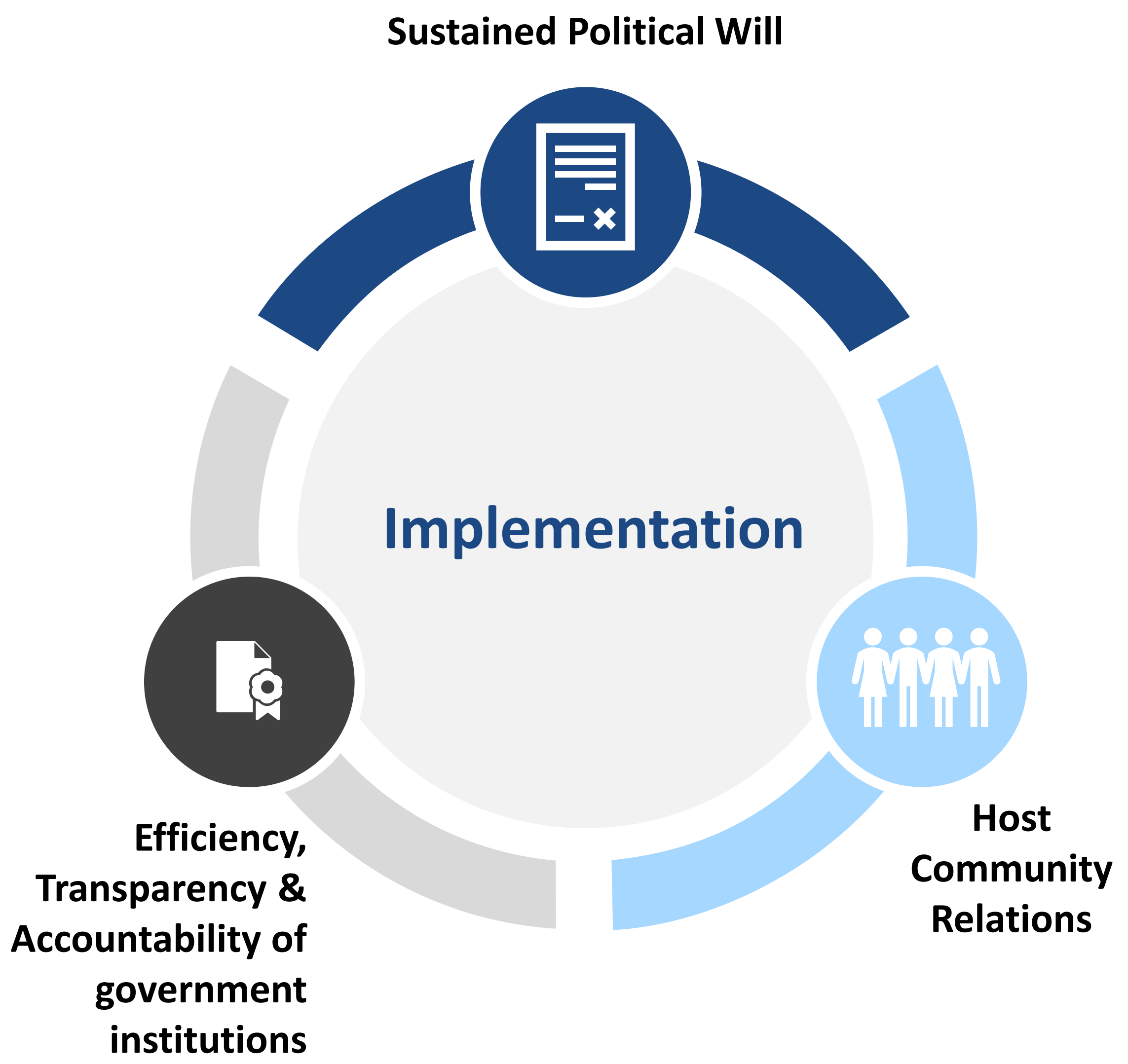
- Nevertheless, there is need for caution on the part of the banks, particularly, due to the uncertainty regarding the implementation of the Act as well as a high exposure risk.

Source: National Bureau of Statistics

Investors in the oil and gas industry are likely to be cautious for the following reasons:

3. Slow pace of implementation of the PIA

- Just like many legislations in Nigeria, the PIA could experience slow pace of implementation of some of the provisions.
- Although the current administration has expressed commitment to develop the oil & gas industry with the inauguration of the Steering Committee on Implementation of the Act, continuity of implementation could become a challenge, especially in view of the forthcoming elections in 2023.
- In addition, we will carefully observe whether the government will summon the political will to implement crucial reforms such as the complete deregulation of the downstream industry.
- Issues relating to transparency and accountability of government institutions have been a major clog in the wheel of progress in the industry. We are less optimistic that the Act will foster more openness and accountability in the industry.
- Challenges associated with the host communities could persist following disagreements over the Host Community Development Trust (HDCT). This could revive agitations in the oil producing regions.



Analysts Views on Bankability of Projects and bank credit to oil & gas sector

There is no doubt that the relatively clear fiscal structure in the Petroleum Industry Act (PIA) could strengthen the investment case for Nigeria's oil and gas sector. As pointed out earlier, Nigerian banks are exposed to the oil and gas sector, with lending to the sector at around 20% of Nigerian banks' total credit and 30% when the power and energy sectors are included.

Beyond the attractive fiscal provisions of the PIA, we think that the bankability of oil and gas deals is also significantly dependent on oil price volatility. The slight decline in the share of banks' credit to the oil and gas sector in 2020 was oil price collapse-induced, a development triggered by the outbreak of COVID-19.

Post PIA, we believe that the blend of oil price recovery, together with the taxes and royalties reduction in the PIA, which is positive for oil economics and cash flows, can trigger Nigeria's banks interest in the oil and gas industry.

Also, given the opportunities in the gas segment as well as government's commitment to provide incentives for investors, Nigerian banks will need to reposition their portfolios in favour of the gas segment, which has greater demand and investment prospects than crude oil. This would be a useful strategy for banks to limit growth of non-performing loans in the medium term.

Analysts Views on Energy Transition

Many countries are transiting to renewable energy. Even the world's largest exporter of crude oil, Saudi Arabia, plans to generate 50% of its energy from renewables by 2030. The Kingdom has in recent years launched several renewable projects, which are part of a broader diversification plan to reduce its dependence on crude oil by 2030. Many other oil producing countries are also developing alternative energy sources. This divestment, coupled with technological advancements will place a cap on oil price in the medium term.

Without downplaying the rapid pace of global energy transition to renewables, we believe Africa will continue to rely heavily on energy from fossil fuels. In several African countries like Nigeria, transition to renewables is slow especially because it requires massive private investments, enabling policies and legislations and large scale renewable solutions. Reaching a near zero-carbon level across the continent means a significant decline in the use of coal, oil, and gas, a move we consider a longer-term strategic goal, especially given the huge usage of internal combustion engine passenger cars and coal/gas powered plants. However, there is a need for urgency in planning for diversification and setting out a clear path to the energy transition.

However, as the least carbon-intensive fossil fuel, gas can play a prominent role in reducing emissions in energy consumption. We understand that some African countries are already instituting policies that encourage natural gas usage in power generation, instead of oil. We also note that gas demand is looking set to rise in transport and the world's shipping fleets are increasingly using LNG as fuel. The positive impact of this will likely keep oil and gas investment afloat in Africa.

That said, based on its huge resource endowment, Nigeria is better positioned to focus on exploring the opportunities in the gas segment of the industry. While the PIA is a good starting point, it must be backed with swift implementation, enabling policies and political will to make decisions that will be beneficial to investors, host communities and the country at large.

Conclusion

Signing the PIA is a positive step towards improving the state of oil and gas in Nigeria

The oil and gas industry plays a pivotal role in Nigeria's macroeconomic performance in terms of investment inflows, export, foreign exchange earnings and government revenue. The lingering debate on the passage and signing of the Petroleum Industry Bill into law has put the industry on a standstill for several decades, leading to lower investment inflows into the sector.

We congratulate President Muhammadu Buhari and the 9th National Assembly for birthing the Petroleum Industry Act (PIA). The PIA presents some level of clarity and certainty about the regulatory and institutional framework of Nigeria's oil and gas industry. The Act presents guidelines for operations in the industry. It also provides clarity on the level of government participation in the industry.

The PIA provides a first leap to the demutualization of the NNPC by incorporating it as NNPC Limited owned by shares. Though the shares of the NNPC Limited are still 100% owned by the government of the Federation of Nigeria, this sets a viable platform for future efficient transfer of shares to the private sector. The Act also makes an attempt to develop the gas sector, address environmental pollution and incentivize investments in the upstream segment of the oil and gas industry.

While the PIA may not address all the challenges facing the oil and gas sector, we believe there is no better time than now to balance the different stakeholders' demand, especially given that the global landscape is swiftly shifting in favour of countries with the most competitive provisions to investors.

Thus, the PIA is a major positive step towards improving the state of oil and gas in Nigeria and it comes with the potential to create new investment opportunities provided the government ensures proper implementation of the Act.

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