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Unlocking Nigerias gas potential

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Nigeria is one of the fastest growing economies in the world, and the recent rebasing of its economy gives hope that with adequate infrastructure and resource management, the economy will continue to develop at a steady rate. This growth is rooted in its crude oil production, which accounts for about 90% of its external revenue.

However, the country's over-reliance on crude oil has become a major source of consternation, more critically in light of the recent falling oil prices. The volatility in oil prices has heightened the call for a more decentralized and diversified economy.

Launched in 2008, the Nigeria Gas Master Plan ("NGMP") outlays the roadmap for the exploitation, rapid development and effective distribution of Nigeria's robust gas reserves. Nigeria has over 187 trillion cubic feet (tcf) of proven gas reserve (comprising 97 tcf associated gas and 90 tcf non-associated gas); the 7th largest natural gas deposit in the world. Of note, there exists a

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tremendous potential to grow as the country holds the 4th largest reserves worldwide. Since the inception of the NGMP, the Nigerian gas sector has witnessed exponential growth, with the gas supply market increasing from 300 million to 2 billion cubic feet per day (cfpd).

While the focus of the Nigerian government and investors has always largely been on crude oil, there are great opportunities for more investments in the Nigerian gas sector.

The Nigerian Gas Industry in Context:

Ominously, the Nigerian gas industry (upstream, midstream and downstream) has a hydra-headed regulatory approach with different governmental regulatory body, entities or corporations responsible for different assignments or mandates in the natural gas value chain. Central to the administration and management of the industry is the Nigerian Gas Company Limited (NGC Limited), a limited liability company incorporated as a subsidiary of the Nigerian National Petroleum Corporation (NNPC). NGC Limited was established in part to: develop an efficient gas industry, manage the integrated gas pipeline network and distribute gas and derivative produces regionally and internationally.

The national gas aspiration as expressed by the NGMP, which essentially focuses on domestic gas utilization chain (at the downstream level), exists in three parts: (i) gas to power; (ii) gas-based industries; and (iii) high value export.

The strategic themes underpinning these aspirations stipulate that by the deadline of 2015:

- Gas to power - supply sufficient gas to Nigerian thermal power plants to drive threefold increase in the plants' generation capacity
- Gas-based industries - transform gas sector to independent value adding sector and create regional hubs for gas-based industries i.e. petrochemical, fertilizer, methanol etc.
- High value export - consolidate Nigeria's position and market share in the high value exports market as well as consolidate national footprint and influence by

completing national and regional pipeline projects.

The above strategic themes have been largely driven by relevant policy thrusts, key amongst which are:

- The Domestic Supply Obligation Regulation in place to ensure short-term gas availability
- The Commercial Framework Reforms a combination of practices, policies, rules and regulations to ensure bankable gas projects and securitization of revenue to ensure sustainable investment in gas by third-party financiers
- Scalable Gas Infrastructure Blueprint borne out of the NGMP with a view to ensure effective distribution and allocation of aggregated gas.

Key Challenges in the Nigerian Gas Industry

Owing to its large-scale proven natural gas reserves, Nigeria is routinely described as a ‘gas province with a little bit of oil in it’. Paradoxically, Nigeria today lives on oil. It is believed that several challenges have stunted the growth of the industry over the years. These challenges range from theft and pipeline vandalism, oligopolistic market form, inadequate infrastructure, paucity of investments, undue government intervention, regulatory capture to politicisation of policy implementation.

A few of the key industry issues are examined below:

- **Pricing:** A major concern for investors is the profitability of producing gas for supply to domestic markets as opposed to the export market. The Nigerian gas market is predominantly export oriented, owing to the competitive international price regime. Recent OPEC reports show that 60% of the gas produced is exported, with the Nigeria Liquefied Natural Gas (NLNG) being a major driver. In the domestic markets, the market prices are less competitive, resulting in a low rate of return on investments for the producers and suppliers. The government’s response was to adopt a sector based pricing strategy, which creates a bespoke pricing regime for each sector. It has been noted that this price regulation is impeding the profitability of gas-producing companies and is a deterrent for most investors, adversely impacting the bankability of gas projects. A case in point, the Power Holding Company of Nigeria, as at 2011 owes its gas suppliers 13billion Naira.

- **Infrastructure**: Although the Gas Infrastructure Blueprint remains a key plank in the NGMP, the prevailing gas strategy that encourages infrastructure to be driven and funded by the government (at the expense of other social sectors) is a failed strategy as government funds would never be adequate to provide the requisite infrastructure to meet demands from load centers.
- **Multi-tier Bureaucratic Industry Regulation:** Whilst NNPC/Department of Petroleum Resources (DPR) has been driving policy initiatives for years in the industry, NGC Limited owns, controls and operates the national pipelines, and the GACN oversees gas supply and pricing. At different levels of the gas value chain, there exist multi-layered rules, policies and guidelines. The lack of a one-stop shop for all gas related issues have constituted a major stumbling block for players in the industry. Further, there is limited capacity across the key regulatory institutions, and a gross lack of corporate and good governance within the industry's multiple intertwined regulatory bodies.
- **Deficit in Gas Supply:** The under-performance of some ageing gas plants has eroded the supply base by about 100mmcf/d (400MW), thereby making these plants require more gas to function. Also, the long gestation period for high impact supply projects puts major supply additions outside the short-to-medium term thereby distorting the country's gas to power strategy.
- **Gas Flaring:** It is simply not commercially viable for oil producers to put in place requisite infrastructural facilities to develop and trap associated gas. Whilst the traditional approaches (flaring deadline and penalties) that had been adopted by the government to discourage flaring have proved abortive, the gas flaring challenge has been heightened by the consistent failure of the government to exercise its right to take flared gas at free cost.

The Mileage Thus Far…

In response to these challenges, the Nigerian government has taken various steps towards ensuring that all noted gas-related issues are frontally tackled as they arise and a selection of these are detailed below:

- **Pricing:** The price for per thousand standard cubic feet (Mcf) of US$0.5 was increased to US$1.5 in 2015. More recently, the government approved a new gas-to-power pricing benchmark, which increases the gas supply price to $2.50 per thousand standard cubic feet (Mcf). This new price regime is applicable to past and future Gas Supply Agreements and came into effect on the 1st of January 2015. Although still not on par with the international gas market, it represents a far more commercially viable deal for investors. In light of the new price increase, implementation of the DSO will be taken more seriously, with tougher penalties being imposed on gas suppliers who fail to meet their quotas.
- **Fiscal Framework:** As shown above, Nigeria's strategic imperative for the short and medium term is in 'domestic' gas development. It is thus not strange that to benefit from most of the fiscal incentives in the industry, the supplier/company must invest in natural gas liquid extraction facility to supply gas in usable form to domestic gas utilization projects. It is important to note that all incentives granted in respect of investment in associated gas shall be applicable to non-associated gas. Today, the industry enjoys the fiscal incentives set out in Table 1.

Gas Sector - fiscal incentives	
1.	All capital investment relating the gas-to-liquids facilities are treated as chargeable capital allowance and recoverable against oil income;
2.	Gas transferred from the natural gas liquid facility to the gas-to-liquid facility shall be at zero percent tax;
3.	Zero percent royalty;
4.	Capital allowance of 90% in the first year of production and 10% retained in the books;
5.	Petroleum investment allowance of 35% (if no tax holiday is exercised or 15% (if tax holiday is exercised);
6.	Tax free period of 3 years in the first instance, and renewable for additional two (2) years subject to

Gas Sector - fiscal incentives	
	satisfactory performance. The tax-free period shall start on the day the company commences production as certified by the Ministry of Petroleum Resources;
7.	Tax free dividend during the tax-free period;
8.	Zero % VAT for plants, machinery and equipment;
9.	Custom duty of 2.5%;
10.	Interests on loan are deductible provided there is prior approval of Federal Ministry of Finance.

- **Infrastructure:** The government, through NGC limited, has achieved great strides in the provision of gas infrastructure. The current NGC Limited gas pipeline infrastructure comprises (approximately 1,100 kilometres):
  - The eastern network- the Alakiri-Obigbo–Ikot Abasi Pipeline
  - The western network- the Escravos–Lagos Pipeline System (ELPS).

Other key gas infrastructure with the participation of the private sector includes:

- Pipeline infrastructure owned by the NLNG, the NNPC/SPDC/Total joint venture
- Pipeline infrastructure belonging to local distribution companies such as Gaslink Limited and Shell Nigeria Gas
- The Olorunsogo pipeline
- West African Gas Pipeline (WAGP) Project II
- ECPS-A – 101 kilometres pipeline project
- Chevron/NNPC EGTL gas-to-liquids processing facility
- NNPC/Mobil JV Oso NGL project.

The Petroleum Industry Bill (PIB), if passed, would open the gas sector to more private investor/sector participation - as the PIB envisages private participation is not only the infrastructure end, but also in the management and ownership of the new NGC Limited or NGC Plc under the PIB.

Concluding Remarks

Gas in Nigeria should be cheaper, cleaner, and healthier than crude oil as an energy service, with abundant socio-economic benefits if developed correctly. To unlock this potential, more focus has to be placed on non-associated gas as Nigeria seems to have made fair inroads in developing associated gas reserve. With the completion of the Uquo gas processing facility in Akwa Ibom, one of the largest projects undertaken by an independent company in sub-Sahara Africa, it is hoped that this will spur further investors' activities in the sector.

The Nigerian government has succeeded in providing a roadmap for investors and key participants. It is imperative that these policy papers are routinely updated and implemented on a going basis together with a conscious drive to increase private sector participation.

This could be done by creating a clear, certain and predictable investment framework for investors – and more certainty on the PIB will be needed for investors who always have an eye on what the future might bring.

The GACN and other industry regulators estimate that US$16 billion investment is required for the sector. This would help unlock opportunities in gas, consulting, financial services and pipe milling and fabrication, among others.

It is hoped that international investors will be sufficiently 'turned on' to gas and these investments will be forthcoming in order for the gas sector and the broader Nigerian economy to flourish.

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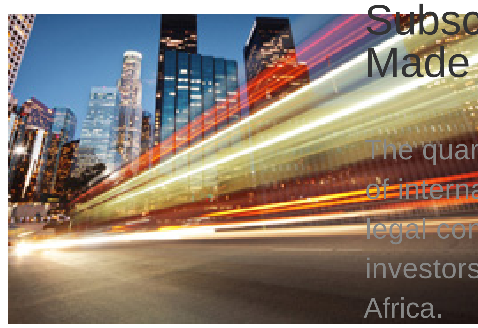

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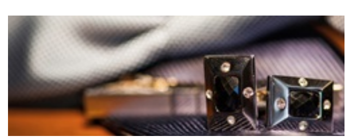

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