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Impact of the Finance Act 2020 on Gas Utilization Projects

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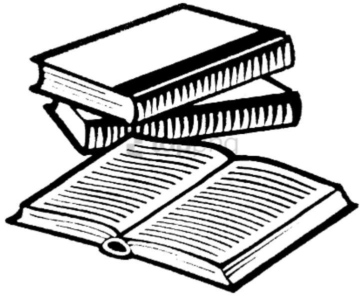
INTRODUCTION



- A flurry of legislative changes introduced by the government in the period 3Q 2019 and 1Q 2020
- Key changes/introduction included the Petroleum Regulations, Finance Act, Deep Offshore Act..

Finance Act introduced to:

- Promote fiscal equity by mitigating instances of regressive taxation.
- Reform domestic tax law to align with global best practice.
- Introduce tax incentives for infrastructure investment
- Support small businesses in line with the EODB reforms
- Raise revenue for government, by various fiscal measures eg, VAT rate increase from 5% to 7.5%

- ***Action 4 of BEPS recommendations seek to mitigate the impact of base erosion arising from excessive interest expense deductions as well as other financial payments on related-party or third-party debt.***

OECD
BETTER POLICIES FOR BETTER LIVES

S/N	LAW AMENDED	# OF CHANGES	REF. FINANCE ACT (Section)
1.	Capital Gains Tax Act	4	2 – 5
2.	Companies Income Tax Act	17	6 – 22
3.	Industrial Development (Income Tax Relief) Act	2	23 – 24
4.	Personal Income Tax Act	9	25 – 33
5.	Tertiary Education Trust Fund (Establishment, Etc) Act	3	34 – 36
6.	Customs and Excise Tariff, Etc (Consolidation) Act	3	37 – 39
7	Value Added Tax Act	6	40 – 45

S/N	LAW AMENDED	# OF CHANGES	REF. FINANCE ACT (Section)
8	Stamp Duties Act	3	46 – 48
9	Federal Inland Revenue Service (Establishment) Act	9	49 – 57
10	Nigeria Export Processing Zones Act	1	58
11	Oil and Gas Export Free Zone Act	1	59
12	Companies and Allied Matters Act	1	60
13	Fiscal Responsibility Act	2	61 – 62
14	Public Procurement Act	12	63 – 74

CITA highest number of amendments (17), followed by the (PPA) which has 12No changes

Changes in Finance Act that Impact Oil and Gas

Changes that impact the oil and gas industry.

1. Inclusion of Withholding Tax (WHT),
2. Increase in Value Added Tax (VAT),
3. New conditions around the Minimum Tax Provision, and
4. Thin Capitalization Rules

S/N	CHANGE IN the FINANCE ACT 2019 / 2020
1	The inclusion of WH Tax on dividends paid by Petroleum Companies
2	Increase VAT from 5% to 7.50%
3	The inclusion of a minimum tax provision for companies with >25% foreign equity **MinTax = 0.5% * (Gross turnover – franked investment income)**
4	The removal of the incentive that allowed Minister-approved interests to be Tax deductible for gas utilization projects.

S/N	CHANGE IN the FINANCE ACT 2019 / 2020
5	Caps tax deductible Interest Expense to 30% of EBITDA for interest payment made to foreign entity. **Limit period of interest expense carry forward to 5years**
6	Reduce the portion of interest on foreign loan which is Tax exempt from 100% to 70% (Thin Capitalization). Available for loans >7yr tenor (including moratorium)
7	Self – charge VAT when goods and services enjoyed by companies outside VAT threshold

Assumptions: Impact Assessment of FA 2020

PROJECT INPUTS		
Construction Start Year	#	2021
Duration of Gas CPF Build	Years	3
Brent Price Reference	$/bbl	45.00
Dry Gas Price to Offtaker	$/mscf	2.00
Gas Plant CapEx	$MM	800.00
Gas Plant Capacity	mmscfd	300.00
Duration of Gas Supply	Years	15
Fixed OpEx	% of CapEx	7.00%
Variable OpEx	$/mscf	0.20
PROJECT FINANCE OPTIONS		
Project Finance	Logic	*1*
Debt Equity ratio	%	70.00%
Interest rate	%	8%
Loan repayment start year	#	2024
Loan Tenor	Years	8.00

FISCAL ASSUMPTIONS		
Tax Holiday	Logic	**YES**
Years Of Tax Holiday	Years	5
Education Tax	%	2%
Initial Capital Allowance	%	0%
Investment Allowance	%	15%
Annual Allowance	%	90%
% of Ass. Profit avail. for CA recovery	%	66.67%
CITA	%	30%
FINANCE ACT		
Interest Limit (of EBITDA)	%	30%
C/forward Limit	Years	5

- Dry gas from the plant is ~ 250mmscfd over 15-year.
- Liquids production starts at ~ 20kbpd and commences decline after 6years.
- At the end of the contractual gas supply, liquids production is expected to be 7kbpd.

Results: Impact Assessment of FA 2020

<table>
<tr><th></th><th>Units</th><th>Project (WOFA)</th><th>Project (WFA)</th></tr>
<tr><td>Revenue</td><td>$MM</td><td colspan="2">5,733.86</td></tr>
<tr><td>Debt Issued</td><td>$MM</td><td colspan="2">560.00</td></tr>
<tr><td>CapEx</td><td>$MM</td><td colspan="2">800.00</td></tr>
<tr><td>OpEx</td><td>$MM</td><td colspan="2">3,615.54</td></tr>
<tr><td>Interest</td><td>$MM</td><td colspan="2">330.08</td></tr>
<tr><td>Principal Repaid</td><td>$MM</td><td colspan="2">560.00</td></tr>
<tr><td>Gov't Take</td><td>$MM</td><td>285.90</td><td>387.63</td></tr>
<tr><td>NCF</td><td>$MM</td><td>702.34</td><td>600.61</td></tr>
<tr><td>NPV 10%</td><td>$MM</td><td>201.68</td><td>165.24</td></tr>
<tr><td>IRR</td><td>%</td><td>21.11%</td><td>19.79%</td></tr>
<tr><td>MCR</td><td>$MM</td><td>264.00</td><td>264.00</td></tr>
<tr><td>Payout</td><td>Yrs</td><td>6.30</td><td>6.30</td></tr>
<tr><td>Gov't Take (%)</td><td>%</td><td>29%</td><td>39%</td></tr>
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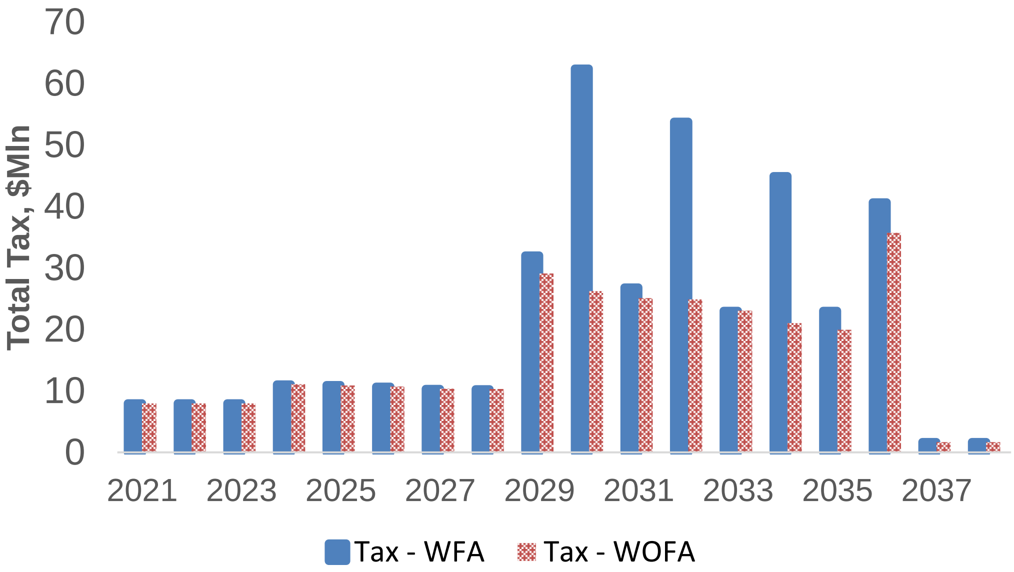
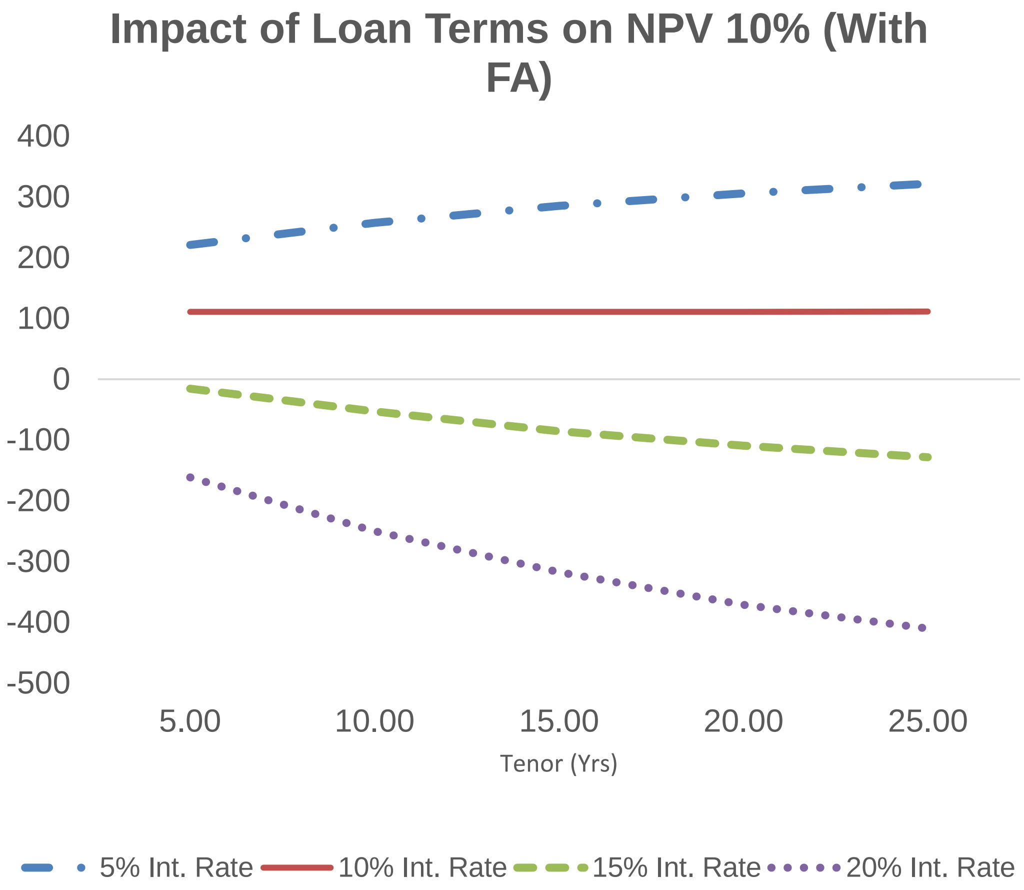
Tax Receipts Profile - with and without Finance Act



- With Finance Act, Investor NPV declines, GT increases.
- low gov't receipts in the years from 2021 to 2028 due to tax holiday
- Without the Finance Act, 100% of interests would have been tax deductible without limit and carried forward till fully recovered

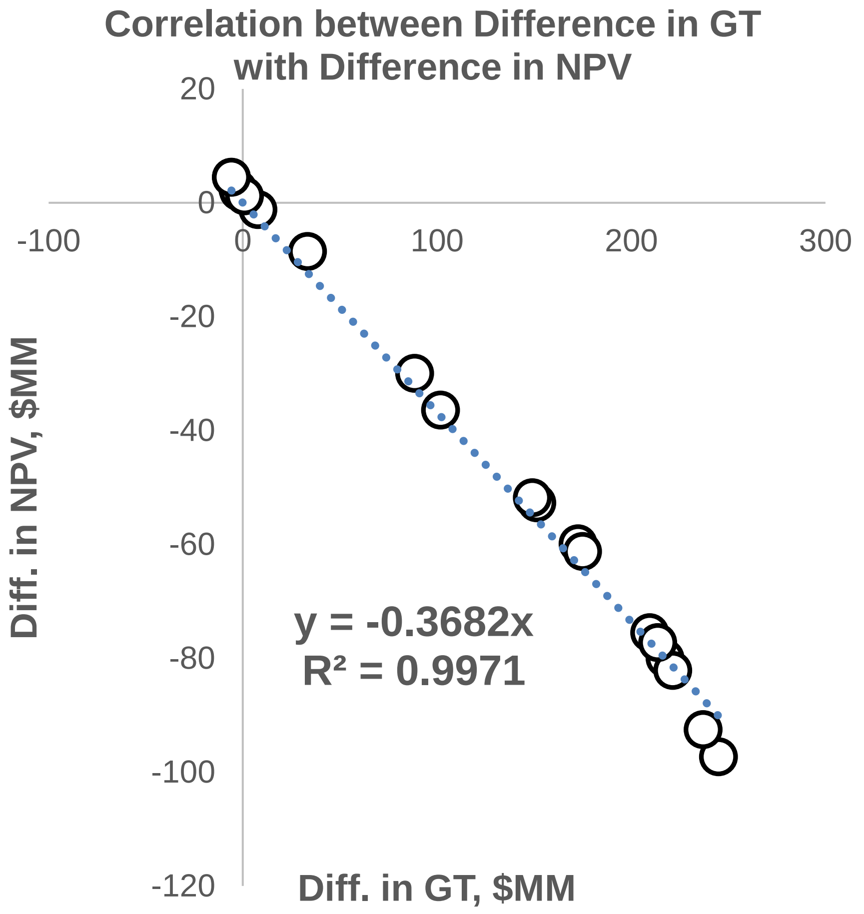
Results: Impact Assessment of FA 2020



Diff. in Gov't Take b/w WFA and WOFA across Loan Terms

Loan Tenor (Yrs)	Interest Rate (%) 5%	10%	15%	20%
5.00	98.57	80.42	68.85	62.14
10.00	111.66	108.65	98.15	96.95
15.00	124.21	128.77	116.93	111.69
20.00	128.28	130.56	118.23	114.20
25.00	129.79	129.60	116.63	101.81

- Above 10% interest rate, NPV across loan terms declines with increasing loan tenor under WFA (and WOFA too)
- Positive differences across loan terms indicates that the FA is acting to preserve / enhance value to govt receipts
- The FA acts to preserve most govt take against extra lengthy loan tenors



Results: Impact Assessment of FA 2020

- The Negative trend between the change in GT with the Change in NPV across loan terms implies that as Change in GT increases, Change in NPV decreases
- Slope of -0.3812 means that for every $1 increase in GT arising from the impact of the Finance Act, the project NPV declines by $0.38
- ***The Finance Act works to improve/preserve GT more than it works to decline project viability***

Conclusion

- Finance Act introduces changes which specifically impact gas utilization projects.
- The impact felt through the treatment of financing costs from foreign loans –arising from amendment of Sec. 39 of CITA – and the Thin Capitalization rules.
- DCF modelling indicates that the FA results in preserved / enhanced govt take while investor NPV is depressed relative to without the FA.
- However, the finance act works to improve/preserve GT more than it works to decline viability of the project to the investor – investor NPV declines by 38cents for every $1 of GT preserved / enhanced.
- Additionally, above certain loan term thresholds (of interest rates and tenors), investor value is seen to decline instead of improving.
- Introduction of the FA should serve the government purpose of plugging tax leakage through excessive financing costs more than it will negatively impact viability of investment in gas projects.
- The Act should not impede stakeholders' ability to align their objectives to address the challenge of powering the local economy via gas while fulfilling Nigeria's climate change commitments by deeper adoption of gas as a transition fuel.

Acknowledgements / Thank You / Questions

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