

Nigerian Oil and Gas Industry Update

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Introduction

The global oil and gas industry had an underwhelming year in 2020 as the twin shocks of the oil price crash and the COVID-19 pandemic adversely influenced demand and supply of crude oil in an unprecedented manner; thus leading Nigeria into its second recession in six (6) years. Nigeria, a country heavily dependent on proceeds of crude oil sales, was forced into reactive strategies, such as palliative measures and several fiscal initiatives, to charge the economy into recovery.

Hopefully, 2021 will be the year of recovery as countries make strategic plans to open up their economies with the supply of vaccines being ramped up and pharmaceuticals striving to meet global demand. We also expect that 2021 will see a rise in demand for crude oil and its derivatives.

We have highlighted some of the recent developments in the industry in Nigeria, how these developments impacted on businesses operating in the sector and what to expect in the coming months of 2021.

1. Recent update on production cuts

In early 2020, the members of the Organization of the Petroleum Exporting Countries (OPEC) along with their allies agreed to reduce crude oil production due to the glut in crude oil inventory as a result of the impact of the COVID-19 pandemic. However, over the past 10 months since the production cut, Nigeria has struggled to remain compliant with the agreed production cut. The country attained a record low production output of about 1.4 million barrels per day (bpd) in December 2020, which was 70,000bpd lower than the agreed cut by OPEC+. This was due a fire incident at the Qua Iboe export terminal.

The OPEC member states met at the start of this year to agree production cuts targets for 2021, setting new targets of 7.2million bpd, 7.13million bpd, 7.05million bpd for January, February and March 2021, respectively. The decision to continue the production cut was necessitated by the second wave of the pandemic and the general slump in the global market. The belief is that the restriction would stabilize international oil market and the economy at large. With the recent seeming steady increase in crude oil price peaking at over \$70 per barrel, there were speculations that the production levels would be increased at the OPEC meeting of March 4, 2021.

However, at this meeting, the member states approved a continuation of the production levels for March and April, except for Russia and Kazakhstan, which could increase production by 130,000 and 20,000 bpd, respectively.

Notwithstanding, Nigeria has set its sights on exploring approaches to improve production of condensates to enable the Country recover lost revenue for the purpose of long-term sustainability – given that condensates are not part of the OPEC cuts. This diversification strategy would ensure business and revenue continuity in the Nigeria economy.

2. Update on marginal oil fields bidding rounds

The ongoing marginal oil field bidding round is in the process of being concluded. The Department of Petroleum Resources (DPR) revealed that the process would be concluded by the first quarter of 2021. The process had 630 applicants out of which 500 scaled through prequalification. However, only 161 were shortlisted for the final stage¹. Based on the latest information, all the 161 companies would be given interest in the available fields at the discretion of DPR. However, all the fields will be operated using special purpose vehicles. As of the time of this publication, DPR has notified the 161 companies of the fields assigned to them but not the names of their partners and equity interest in those fields.

The Federal Government (FG) expects to generate about US\$500 million from this exercise, based on the signature bonus payable on the 57 fields. The FG has also communicated that the payment for the signature bonus on the acquisition of the oilfield can be made in Naira or United States Dollars (USD) within 45 days of the notification. This development is occasioned by the scarcity of USD in Nigeria and an intentional measure to curtail the circulation of USD in the economy in a bid to strengthen the Naira.

The bid round has not been as transparent as stakeholders would have wanted. It is difficult to understand why the DPR cannot simply publish the list of the winners and all relevant information on its website in accordance with leading practices. Hopefully, this is one of the areas that the Petroleum Industry Bill (PIB) will address when enacted into law.

¹ <https://www.thisdaylive.com/index.php/2021/02/08/auwalu-ongoing-marginal-fields-bid-round-to-end-this-quarter/>

3. Governments to cut cost of oil production

With declining revenues from decreasing global consumption of crude oil, Nigeria has acknowledged that it needs to be competitive to boost its margins. In 2019, the operating cost for exploration and production companies was estimated at \$48. This was slightly higher than that of comparable African countries, such as Angola and Uganda, at \$45 and \$44, respectively². According to the Minister of State for Petroleum Resources, the current average cost of production per barrel is between \$20 and \$30 depending on the terrain. However, the cost per barrel in Saudi Arabia is \$7.

Regulators and operators have attributed the high cost of production to factors such as long contracting cycle, multiple government taxes and levies, crude theft, bunkering and the general cost of security for oil fields. The Government has, therefore, launched the Nigerian Upstream Cost Optimization Program with the sole objective of reducing cost. The program aims to reduce the average cost per barrel to below \$10 and contracting cycle to 6 months from an average of 18 months.

The President has also commissioned the integrated resource complex, the National Oil and Gas Excellence Centre (NOGEC), which aims to drive safety, value and cost efficiency in the industry, under the supervision of the DPR. The NOGEC encompasses five units namely; Search, Rescue and Surveillance (SeRAS) Command and Control Centre, the National Improved Oil Recovery Centre (NIORC), the Oil and Gas Alternative Dispute Resolution Centre (ADRC), the Oil and Gas Competence Development Centre (CDC) and the Integrated Data Mining and Analytics Centre (IDMAC).

These centers are expected to provide cost-effective data and analytics solutions for investors, financiers, operators, including resources for oil and gas capacity building and training. It is expected that the provision of these resources would achieve the desired results to ensure that Nigeria is competitive in the global markets.

4. Ray of sunshine in the dark cloud of the oil crisis

Oil prices fell in April 2020 to about \$18.38 with West Texas Intermediate (WTI) futures hitting negative figures for the first time. Countries, like Nigeria, were distressed by the possibility of lower prices amidst an already tough year, which eventually led the country into its second recession in less than six (6) years. However, with the easing of the lockdown globally, crude oil prices have risen gradually. Currently, oil prices range between \$64 and \$68³.

Also, OPEC has ensured cumulative output rise for the seventh consecutive month in January 2021, at 25.75 million barrels per day⁴, even with the drop in Nigerian and Libyan production volumes. The biggest suppliers, Saudi Arabia and Iraq, balanced the shortfalls.

This sustained increase in oil prices bodes well for Nigeria's revenue projections, given that the benchmark price in the 2021 budget is US\$40 per barrel, thus providing much needed revenue to cushion the budget deficit. The question that everyone is asking is whether this is a start of an oil price super cycle. Time will tell.

5. Impact of the Covid-19 pandemic on oil servicing activities in the upstream oil and gas sector

Oil servicing companies had a tough year in 2020 as crude oil exploration and production companies, some of which still had subsisting cost cutting measures in place from the previous downturn in 2016, doubled down on these measures due to the onset of Covid-19 pandemic last year. This caused the value of 2020's awarded contracts globally to drop drastically to 16-year record low of \$446 billion⁵.

Also, limited investments took its toll on exploration activities, as Nigeria's annual rig count figures declined by 27.8 per cent to 135 in 2020, from 187 in 2019. There was a steady reduction in the level of activities all through the year with the highest count of 56 rigs in the first quarter, while in subsequent quarters, it declined to 33, 24 and 22 rigs, respectively. In 2019, the figures were 43, 42, 47 and 55 rigs for the first, second, third and fourth quarters respectively⁶. This decline is indicative of the tumultuous year for the oil service sector and crude oil exploration and production in 2020 due to the Covid-19 pandemic.

While there seems to be a steady rise in crude oil prices, it appears that oil service activities are yet to match this rise in Nigeria – with the country's oil rig count at 6 rigs at the end of January 2021, down from 7 in December 2020⁷. It could, therefore, be the case that upstream sector is still operating on a cautious level, with anticipation of a favorable global economic climate in 2021 and perhaps, an improved fiscal regime in the sector with the possible passage of the highly await Petroleum Industry Bill, 2020.

Conclusion

Despite the challenges in the industry and economy at large, there is every reason to be hopeful of a return to a positive economic climate, especially as the country exited recession in the 4th quarter of 2020. It is also expected that in the coming months, the level of economic uncertainty would reduce due to the curtailing measures introduced by the Federal Government and the administration of vaccine in the country.

This would have a positive impact on businesses and possibly boost activities in the oil and gas sector – which remains critical for the economic survival of the country.

² <https://www.dpr.gov.ng/strengthening-nigerias-quest-for-cost-reduction-from-barrel-to-pump/>

³ <https://www.energymixreport.com/oil-closes-in-on-60-bbl-as-supply-cuts-stimulus-hopes-lift-prices/>

⁴ <https://www.energymixreport.com/opec-january-oil-production-rises-for-7th-month-nigeria-limits-gain/>

⁵ <https://www.energymixreport.com/oilfield-services-sector-will-struggle-to-repeat-former-glory-amid-energy-transition-push-rystad>

⁶ <https://www.energymixreport.com/nigerias-oil-rig-count-down-29-to-135-in-2020/>

⁷ <https://www.energymixreport.com/nigerias-oil-rig-count-down-29-to-135-in-2020/>

How we can help

At KPMG, our purpose is to inspire confidence and empower change. We have an Oil and Gas Team made up of professionals with diverse experience and knowledge in accounting, tax, mergers and acquisitions, advisory and regulatory practices. You can, therefore, count on us as a valuable partner with respect to meeting your needs in the industry. Please contact the following for additional information:

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