Country overview

Nigeria, the leading oil and gas country in Africa

Nigeria is the largest oil producer in Africa with proven geology, and long established infrastructure, regulatory and fiscal regimes. Nigeria also possesses one of the largest gas reserves on the continent, the development of which to supply the rapidly evolving and expanding domestic market is an attractive growth opportunity for Seplat.

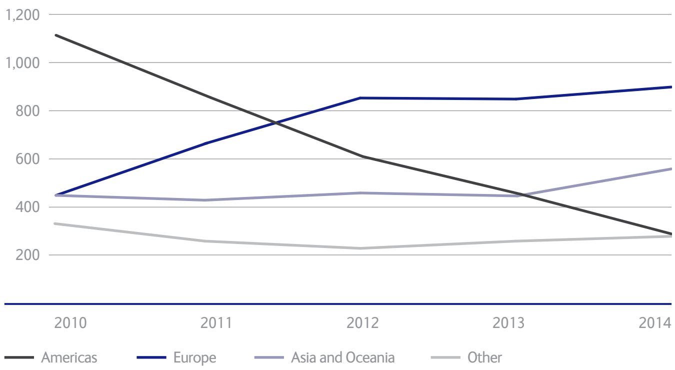
Prolific hydrocarbon geology

Nigeria's oil and gas industry represents a compelling value proposition and is attractive, not just to Seplat but the wider industry also, on many levels. It starts below the ground and the prolific hydrocarbon geology of the Niger Delta area, where Nigeria's oil and gas industry is concentrated. Covering an area of approximately 75,000 km^2 and with up to 10km sedimentary thickness, the critical factors required for hydrocarbon generation have all combined to great effect in the Niger Delta basin, namely the existence of source rocks with high levels of organic content, high rates of sedimentation and rapid burial to allow hydrocarbon generation and the presence of good quality reservoir rocks and effective trap/seal mechanisms where hydrocarbons have accumulated in vast quantities. Nigeria is estimated to hold remaining recoverable proved reserves of around 37 billion barrels of oil and 179 trillion cubic feet of gas, making it a globally significant source of long-term supply.

A globally significant oil producer

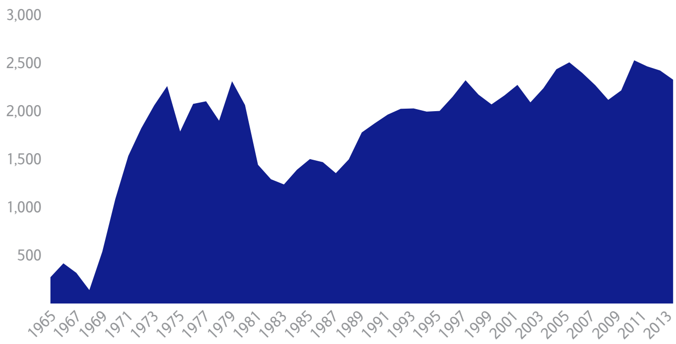
In terms of oil production, Nigeria has consistently produced in excess of 2 million barrels per day since the mid 1990s and is an important supplier to some of the world's major economies. Historically the US has been the largest importer of Nigerian oil but in recent years, as a result of the shale oil boom that has led to oil self-sufficiency there, imports from Nigeria have decreased from over 10% of crude oil imports in 2010 to less than 1% in 2014. However, international demand for Nigerian oil has remained elsewhere, with exports to Europe and Asia in particular increasing in recent years, but not sufficiently to wholly offset the reduced US demand for Nigerian blends.

Nigeria's crude and condensate exports by region (thousand barrels/day)



Source: US Energy Information Administration based on Lloyd's List intelligence (APEX tanker data)

Nigeria's historical oil production ('000 bopd)

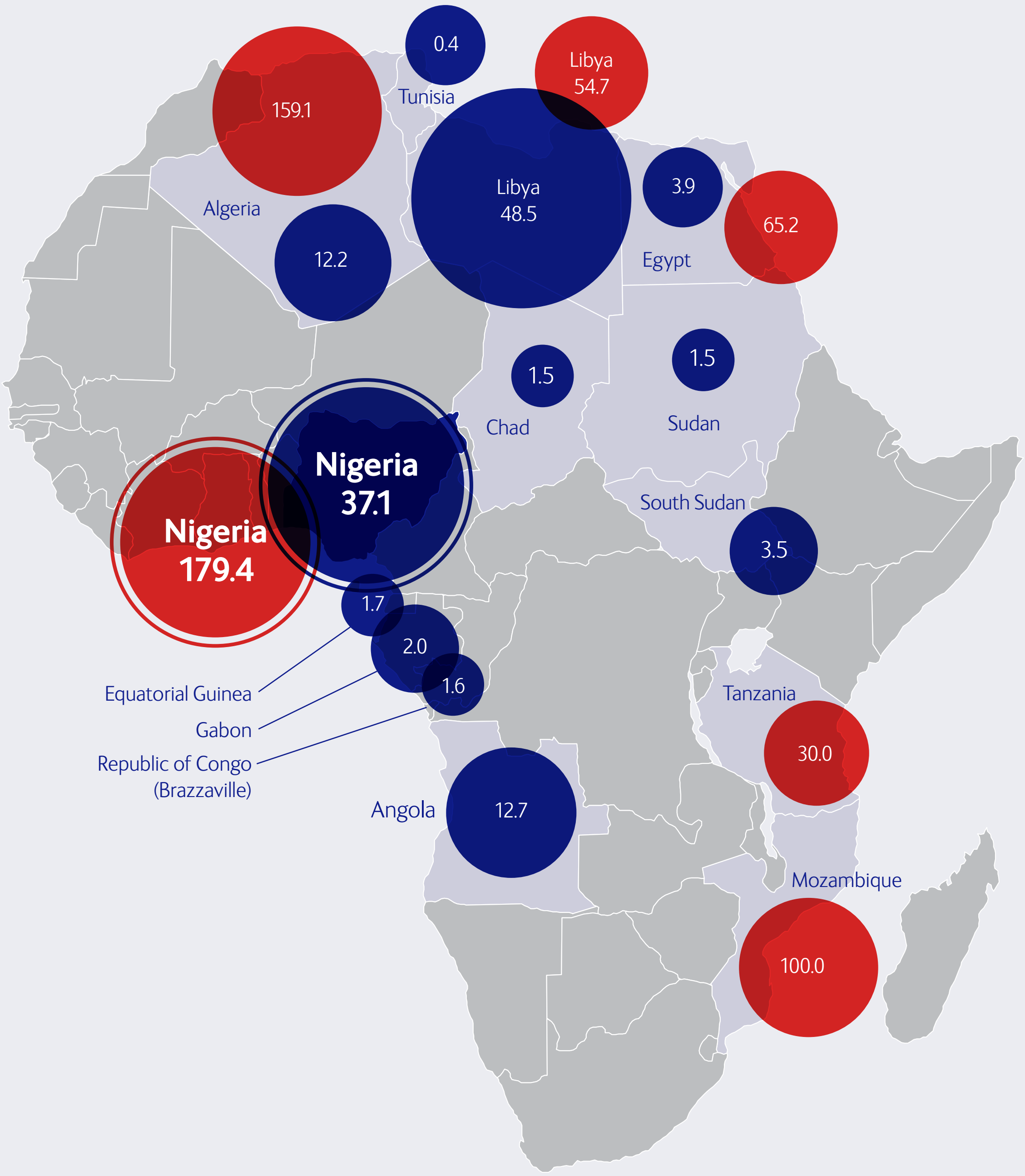


Source: BP Statistical Review of World Energy, June 2014

Africa's leading oil and gas countries

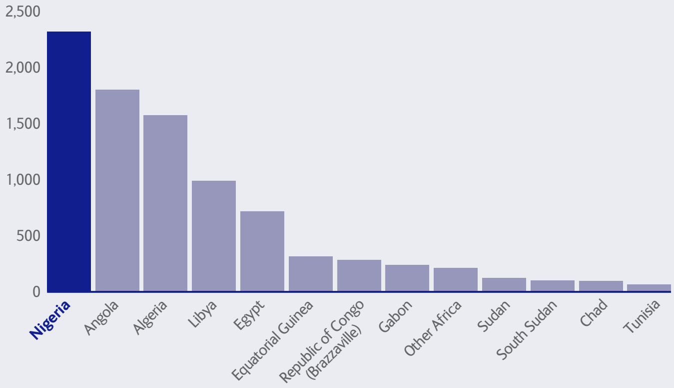
Oil reserves (billion barrels)
Gas reserves (Tscf)

Source: BP Statistical Review of World Energy, June 2014



Nigeria – the largest oil producer in Africa

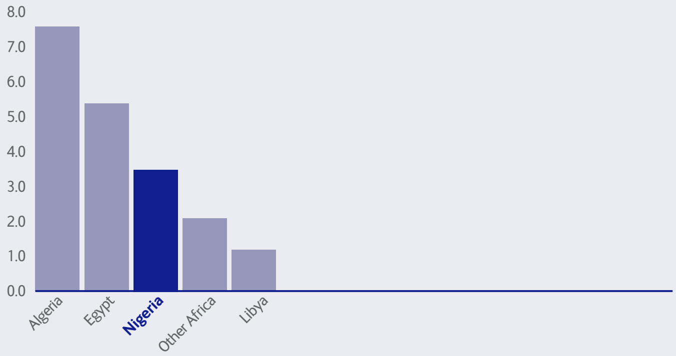
African oil producers ('000 bopd)



Source: BP Statistical Review of World Energy, June 2014

Nigeria – the third largest gas producer in Africa

African gas production (Bscf/d)



Source: BP Statistical Review of World Energy, June 2014

Country overview continued

Oil production challenges

2014 presented many challenges to the industry and Nigeria was no exception. The abrupt decline in oil prices witnessed in the second half of the year following a sustained period of prices over US$100/bbl combined with other exogenous factors, such as a slow-down in some major economies and US Dollar strength/Naira weakness, contributed to an overall contraction of Nigerian oil production throughout the year. According to data from the Nigeria National Bureau of Statistics, average crude oil production fell from 2.26 million barrels per day in the first quarter of 2014 to 2.15 million barrels per day in the third quarter before recovering slightly to 2.18 million barrels per day in the fourth quarter. Although the headline rates remain impressive, development of the Nigerian industry has persistently been hindered by disruption to key transmission infrastructure, oil theft, delays to new projects and limited exploration drilling in recent years, meaning that Nigeria's full oil production potential has not been realised.

Domestic gas monetisation opportunity and challenges

Nigeria presently has one of the lowest rates of electricity generation per capita in the world, with supply falling well short of demand. Historically, investments in gas processing have been dominated by export projects, with LNG accounting for the majority of gas monetised between 2010 and 2013. However, the Nigerian government is implementing an ambitious strategy to triple natural-gas production capacity to 11 billion cubic feet a day by 2020 to fulfil electricity and industrial development demand. The government has created a favourable policy environment for producers seeking to commercialise their gas reserves by increasing gas tariffs to help spur supplies domestically. This is reflected in the domestic service obligation price that has steadily increased from US$1.0/Mscf in 2010 to the current level of US$2.50/Mscf effective in 2015. The Nigerian upstream sector has an exciting opportunity set for those players also able to take advantage of improving domestic market conditions for monetising their gas reserves over and above domestic supply obligations, by selling to commercial ventures in Nigeria such as power plants and manufacturing plants, with gas prices in excess of US$3/Mscf now achievable and being realised under willing buyer/willing seller contracts.

Petroleum Industry Bill

The 2012 draft of the Petroleum Industry Bill ("PIB") remains in the Nigerian National Assembly, Nigeria's Federal legislature, under review. The PIB seeks to effect wide-reaching changes to the structure of the petroleum industry by creating new regulatory agencies, proposing the implementation of new licensing regimes for activities in both the upstream and downstream petroleum industry, as well as the introduction of a new tax regime in the upstream sector, which will supersede the current regime under the Petroleum Profits Tax Act. Whilst it is widely expected that, when passed, the PIB will provide incentives and business opportunities to Nigerian registered and owned oil and gas companies, such incentives and opportunities are yet to be confirmed.

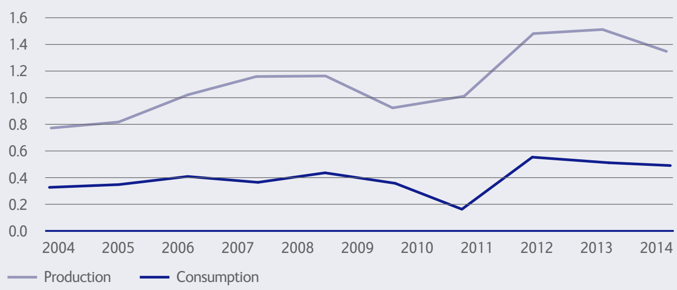
A vast natural gas resource

Nigeria is estimated to hold the largest natural gas reserves in Africa and, impressively, the ninth largest in the world. Despite this, Nigeria ranks as only the 23rd largest gas producer globally but is among the top five exporters of liquefied natural gas ("LNG").

These statistics reflect the comparatively limited opportunities to date for producers to monetise natural gas reserves in the domestic market. The main constraints have been a lack of gathering and transmission infrastructure and the pace at which investments have been made to increase generation and distribution capacity in high volume demand sectors such as gas fired power generation. A significant amount of gas produced in association with oil production has also been flared in Nigeria.

In recent years as much as 15% of gross produced gas volumes have been flared, or around 430 billion cubic feet per year. It has become a priority of the Nigerian government to implement a "flare-out" policy and impose fines where flaring is still taking place. Alongside this, the Gas Master Plan has been developed in order to promote investment in new gas pipeline infrastructure and gas fired power plants to allow Nigeria to derive far greater benefit from its own domestic sources of energy supply and provide much needed electricity generation to meet growing demand and displace the widespread burning of substantially more expensive fuels such as diesel.

Nigeria's dry natural gas production and consumption (trillion cubic feet)



Source: US Energy Information Administration, OPEC Annual Statistical Bulletin 2014

A burgeoning indigenous upstream E&P sector

The rising importance of Nigeria's indigenous oil companies has seen it become one of the fastest-growing segments of the global energy business. Over the past 50 years, Nigerian E&P acreage has been tightly controlled by a small number of Major IOCs and state ventures. Underinvestment in recent years due to local risks including oil theft and bunkering impacting IOC operations has caused underperformance and underdevelopment in the Delta. This presented an opportunity for established indigenous independents that have demonstrated impressive track records of optimising asset performance in the region to exploit the remaining potential and bid for those assets. Over the past five years, indigenous operators – including Seplat – have bought assets worth around US$5bn from the IOCs. It is estimated that indigenous operators presently account for around 11% of total Nigerian oil production and that this figure will increase substantially over the coming years as more assets are traded into indigenous ownership.

In light of the above-ground issues that have threatened the Nigerian oil and gas sector in recent years, the Government of Nigeria has taken significant steps to increase the level of indigenous participation in the oil and gas industry through the enactment of the Local Content Act. The Act not only presents advantages to the indigenous operators seeking to acquire oil licences in-country but also guarantees the creation of composite value to the Nigerian economy by a systematic development of capacity and capabilities through the deliberate utilisation of Nigerian human resources and services in the Nigerian oil and gas industry. This inclusive approach has re-engaged the disenfranchised local communities and militants that can threaten the performance of oil and gas operations.

Seplat's opportunity

With a reputation as a trusted partner for local stakeholders and with a successful track record in securing value accretive acquisitions from IOCs in the Niger Delta, Seplat's candidacy in government bid rounds and for securing further divested assets from the Majors – as they refocus their Nigerian portfolio towards deeper waters offshore in the Gulf of Guinea that are less heavily explored and offer prospectivity aligned to their materiality thresholds – is strong. The regulatory developments that prioritise indigenous oil and gas companies in Nigeria will also give rise to further acquisition, farm-in and partnership opportunities possibly allowing for increased liquidity in a secondary asset market with greater ownership by indigenous independents.

The domestic demand for gas and the favourable policy environment for developing Nigeria's gas reserves have allowed Seplat to prioritise the commercialisation and monetisation of its significant gas assets. The Company's working interest natural gas reserve and resource base is 827 bcf of gas (2P and 2C), which provides a platform for significant potential growth for the Company whilst simultaneously providing a solution to meet domestic gas demand. The fact that domestic gas prices are de-linked to the oil price is an attractive proposition and means that Seplat's gas strategy can also provide a natural hedge to the highly volatile oil price environment that faces the wider industry.